SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 349

GUY T. HELVERNG, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

AMERICAN CHICLE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

INDEX

	Original	Print
Proceedings before U.S. Board of Tax Appeals	1	1
Docket entries	1	1
Petition	4	2
Exhibit "A"—Notice of deficiency	9	5
Answer	12	6
Amendment to answer	14	7
Findings of fact and opinion, McMahon, M	19	10
Decision	30	16
Petition for rehearing	31	16
Notice of filing and hearing motion	33	17
Order reversing and modifying opinion	34	18
Decision	36	19
Motion for reconsideration and modification of decision	37	19
Order denying motion for reconsideration, etc	40	21
Memorandum, McMahon, M	42	22
Petition for review and assignments of error	44	23
Notice of filing petition for review	51	27
Praecipe for record	53	27
Clerk's certificate [omitted in printing]	55	28
Proceedings in U.S.C.C.A., Second Circuit	56	28
Opinion, per curiam	56	28
Judgment	58	30
Clerk's certificate [omitted in printing]	60	30
Order allowing certiorari	61	30

1 Before United States Board of Tax Appeals

Docket Number 29897

AMERICAN CHICLE CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Docket entries

Appearances:

For Taxpayer: PAUL L. PEYTON, Esq.

For Commissioner: B. M. COON, F. B. SCHLOSSER, Esq.

1927

July 23—Petition received and filed. Taxpayer notified. Fee paid.

" 25—Copy served on General Counsel.

Sept. 21—Answer filed by G.C.

" 23—Copy of answer served on taxpayer. Gen. Cal.

1929

Oct. 3—Hearing set 12-3-29.

Dec. 3—Hearing held before Stephen J. McMahon, div. 16, on merits, stipulations as to facts and amendment to answer filed. Briefs due Jan. 6, 1930.

2 Dec. 20—Transcript of hearing of Dec. 3, 1929 filed.

" 28—Brief filed by taxpayer.

1930

Jan. 4—Brief filed by G.C.

1931

May 14—Findings of fact and opinion rendered, S. J. McMahon, div. 16, judgment will be entered under rule 50.

July 10—Notice of settlement filed by G.C.

" 14—Hearing set Aug. 5, 1931, on rule 50.

" 22—Consent to settlement filed by taxpayer.

" 29—Decision entered, Charles P. Smith, div. 5.

Dec. 8—Petition for rehearing filed by G.C.

" 9—Hearing set Dec. 16, 1931, on motion.

" 16—Hearing had before S. J. McMahon, div. 16, on respondent's motion for rehearing, C.A.V. Briefs due 15 days from date.

" 29—Transcript of hearing of 12/16/31 filed.

" 30—Memorandum in opposition to motion for rehearing filed by taxpayer.

" 31—Brief filed by G.C.

1932

Jan. 26—Order that opinion promulgated May 14, 1931 be reversed and modified; that decision entered July 29, 1931, be vacated; that respondent's petition for rehearing be denied in certain particulars; and that proceeding be restored to day cal. of Feb. 17, 1932, by which date parties shall file recomputations as per this order entered.

3 Feb. 10—Notice of settlement filed by taxpayer, 2/11/32. Copy served on G.C.
Feb. 17—Hearing had before Mr. Marquette on settlement under rule 50. Not contested. Referred to Mr. McMahon for decision.
" 23—Decision entered, S. J. McMahon, div. 16.
Mar. 10—Motion for reconsideration and modification of decision filed by G.C.
July 12—Order denying motion of Mar. 10, 1932, entered.
Aug. 19—Petition for review by U.S. Cir. Ct. of App. (2nd) with assignments of error filed by G.C.
" 25—Proof of service filed.
Oct. 17—Motion for extension to Nov. 30, 1932, to complete and transmit record filed by G.C.
" 17—Order for extension to Nov. 30, 1932, to prepare evidence and record entered.
Nov. 21—Praecipe filed—proof of service thereon.
" 30—Order enlarging time to Jan. 16, 1932, for transmission and delivery of record sup petition for review, entered.

4 Before United States Board of Tax Appeals

[Title omitted.]

Petition

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:CR:E—60D—E.F.C., dated May 26, 1927, and as a basis for its proceeding alleges as follows:

1. The petitioner is a corporation organized and existing under the laws of the State of New Jersey, with principal office at Thomson Avenue & Manly Street, Long Island City, New York.

2. The notice of deficiency (a copy of which with schedules is attached and marked "Exhibit A") was mailed to the petitioner on May 26, 1927.

3. The amount of deficiency is $26,094.07 covering income tax asserted for the years 1924 and 1925 and the amount thereof in controversy is $9,721.79.

4. The determination of the tax set forth in said notice of deficiency is based upon the following error:

"(a) The Commissioner has included in taxable income for each year in dispute the difference between the maturity value
5 (par value) and the price paid by the taxpayer in the open market for certain of its own bonds and notes."

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) In the year 1909 the Sen Sen Chiclet Company, a Maine corporation, issued $2,700,000 face value of bonds maturing May 14, 1929, with a sinking-fund clause providing that a deposit be made with

the trustee of at least $50,000 per year, to provide for the purchase of bonds submitted to the trustee in open bid by bondholders under the terms of the indenture.

(b) In August 1914 petitioner acquired all of the assets of said Sen Sen Chiclet Company and assumed the payment of the liabilities of said company, among which were $2,425,000 par value of said bonds then outstanding and unredeemed.

(c) Due to expansion of petitioner's business, petitioner on October 1, 1919, issued $2,500,000 par value of its 6% notes maturing serially October 1, 1920 to 1927, inclusive.

(d) In October 1922 such serial notes remaining unredeemed at that time in par value of $1,710,000 were refunded by the issuance of petitioner's five-year notes maturing October 1, 1927, in the same amount of $1,710,000.

(e) Petitioner duly filed its income-tax return for the year 1922, which showed a net loss for the calendar year 1922 of $840,376.76. In the computation of this net loss there was included
6 $16,767.50 of income and the Commissioner added further income in the amount of $9,581.56, making a total of $26,349.06, based on the following facts:

(f) During said year 1922 petitioner purchased from the public $82,000 par value of said Sen Sen Chiclet Company bonds and paid therefor $55,650.94.

(g) The Commissioner, in arriving at the deficiency for 1924, reduced said net loss for 1922 on account of certain items to which petitioner does not object. However, petitioner claims that said net loss for 1922 should, on the other hand, be increased by the elimination of $26,349.06 of supposed profit on said 1922 bond purchases and the Commissioner has refused to eliminate said supposed profit.

(h) Petitioner duly filed its income-tax return for 1924 and included therein as taxable income $35,457.45, computed upon the following facts:

(i) During said year 1924 petitioner purchased from the public $15,000 par value of Sen Sen Chiclet Company bonds and paid therefor $11,391.00, and also purchased from the public during said year $769,500 par value of said five-year six percent notes and paid therefor $745,440.45, and the trustee of said sinking fund also purchased from the public in said year $44,000 par value of said Sen Sen Chiclet Company bonds and paid therefor $36,211.10. Petitioner claims that said sum of $35,457.45, representing the difference between the par value and the amounts paid for said bonds and
7 notes does not constitute taxable income to petitioner and should be eliminated from its 1924 tax return in arriving at any deficiency for said year 1924, but the Commissioner has refused to do so.

(j) Petitioner duly filed its income-tax return for the calendar year 1925 and included therein as taxable profit $15,353.69, based on the following transactions:

(k) During said year petitioner purchased $166,500 par value of Sen Sen Chiclet Company bonds from the public and paid therefor $152,016.81; and the trustee of said sinking fund likewise purchased from the public $35,000 par value of said bonds and paid therefor $34,129.50. Petitioner claims that said sum of $15,353.69 reported as profit in its 1925 tax return should be eliminated in computing any tax deficiency for said year 1925, but the Commissioner has refused to do so.

(l) For several years, beginning with the year 1920, petitioner suffered so greatly from business reverses that large blocks of said bonds and notes were thrown on the market at prices considerably below par. At these low prices the petitioner went into the market and purchased such bonds and notes as it could.

(m) The Commissioner claims that inasmuch as these bonds were issued many years ago at their face value the petitioner derived an income in said years from the purchase of these bonds equal
8 to the difference between the issue price and the purchase price.

Petitioner contends that it derived no taxable income from the purchase of its own bonds at less than the issue price for the reason that it simply used a portion of its cash on hand to pay a portion of its debts.

6. The petitioner prays for relief from the deficiency asserted by the respondent on the following grounds:

(a) That the facts herein set forth are governed by the principle laid down by the United States Supreme Court in the case of Bowers v. Kerbaugh-Empire Co., decided May 3, 1926, and reported in 271 U.S., and that such alleged income does not constitute taxable income.

(b) That such alleged profit is not taxable income within the meaning of the law is also shown by the decision of the United States Board of Tax Appeals in the case of Independent Brewing Company of Pittsburgh, Docket No. 3242, September 18, 1926, in which the Board decided that bonds issued by petitioner and purchased in the open market by them at a cost less than face value did not result in taxable income.

Wherefore petitioner prays that this Board may redetermine the deficiency herein alleged.

AMERICAN CHICLE COMPANY,
Petitioner.

Per A. A. MASTERSON,
A. A. MASTERSON, *Treasurer.*

[Verified by A. A. Masterson on July 22, 1927.]

Exhibit "A" to petition

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, May 26, 1927.

IT:CR:E—60D
EFC

AMERICAN CHICLE COMPANY,
Thomson Avenue & Manly Street,
Long Island City, New York.

SIRS: An examination of your income-tax returns in connection with a revenue agent's recommendations, discloses no change in tax liability for 1922 and 1923 and additional taxes aggregating $26,094.07 for 1924 and 1925, as shown on the attached statement and explained in Bureau letter dated May 17, 1927.

In accordance with the provisions of section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D.C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the collector of internal revenue. No claim for abatement can be ascertained.

If you asquiesce in this deteremination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed form A, and forward it to the Commissioner of Internal Revenue, Washington, D.C., for the attention of IT:CR:E—60D, EFC. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
Commissioner.
By C. R. NASH,
Assistant to the Commissioner.

Inclosures:
Statement.
Form A.
Form 882.

11 *Statement—year examined and forms filed*

	Years	Forms
Company:		
American Chicle Company, Long Island City, New York	1922	1120
	1923	1120
	1924	1120
	1925 (3)	1120
Subsidiary:		
Sen Sen Chiclet Company, Long Island City, New York	1922	None
	1923	None
	1924	None
	1925	None

Tax liability

	Years	Additional tax
American Chicle Company, Long Island City, New York	1922	None
	1923	None
	1924	$19,419.17
	1925	6,674.90
Aggregate additional tax		26,094.07

The revenue agent's report dated December 22, 1926, a copy of which was furnished you, has been accepted as submitted as explained in Bureau letter dated May 17, 1927.

In determining the above-stated results due consideration has been given the statements made in your letter dated May 19, 1927, and accompanying brief dated March 28, 1927, but the Bureau is unable to concede your requests for the reason that the Commissioner has not acquiesced in the decisions upon which you have based your protest.

12 Before United States Board of Tax Appeals

[Title omitted.]

Answer

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, general counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.
3. Admits the allegations contained in paragraph 3 of the petition.
4. Denies the Commissioner erred in respect to the matters set forth in paragraph 4 of the petition.
5. (a), (b), (c), (d), (e), and (f) admits the allegations contained in subdivisions (a), (b), (c), (d), (e), and (f) of paragraph 5 of the petition.

5. (g) Admits the allegations contained in subdivision (g) of paragraph 5 of the petition, but denies the refusal to eliminate from profits for 1922 the sum of $26,349.06 is erroneous.

5. (h) Admits the allegations contained in subdivision (h) of paragraph 5 of the petition.

13 5. (i) Admits the allegations contained in subdivision (i) of paragraph 5 of the petition, but denies that the refusal to eliminate from 1924 income the said sum of $35,457.45 is erroneous.

5. (j) Admits the allegations contained in subdivision (j) of paragraph 5 of the petition.

5. (k) Admits the allegations contained in subdivision (k) of paragraph 5 of the petition, but denies the refusal to eliminate from 1925 income the sum of $15,353.69 is erroneous.

5. (l) Denies the allegations contained in subdivision (l) of paragraph 5 of the petition.

5. (m) Admits the allegations contained in subdivision (m) of paragraph 5 of the petition, but denies the contention of the petition is correct.

Denies each and every other allegation contained in the petition of the above-named taxpayer not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the appeal be denied.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

Of counsel:
SHELBY S. FAULKNER,
Special Attorney,
Bureau of Internal Revenue.

14 Before United States Board of Tax Appeals

[Title omitted.]

Amendment to Answer

The Commissioner of Internal Revenue by his attorney, C. M. Charest, general counsel, Bureau of Internal Revenue, for further answer to the petition of the above-named taxpayer adds to the answer heretofore filed the following:

6. (a) The petitioner reported on its original income-tax return filed for the year 1923 a profit in the amount of $12,428.42 on the purchase and retirement of American Chicle Company 6% five-year notes in the sum of $256,500.00, which cost $244,071.58.

(b) That the discount on said American Chicle Company 6% notes (referred to in paragraph 6 (a) from October 1, 1922, to date of maturity October 1, 1927, is $9,496.14, of which $2,374.04 is discounted from date of issuance to date retired and $7,122.10 from date retired to date of maturity.

(c) That the respondent in the audit of the return for the year 1923 as shown in the notice of deficiency dated May 26, 1927, reduced the net income reported as reflected in the profit of $12,428.42 on the purchase of the American Chicle Company 6% notes by the sum of $7,122.10 on account of offsetting said profit by the amount of discount from date of retirement to date of maturity.

(d) That the details of the computation of the said reduction of profit is set forth in schedule "A" attached hereto and made a part of this answer.

7 (a) In 1924 petitioner also purchased from the public $769,500 par value of its said five-year notes and paid therefore $745,440.45, the difference between the par value of said bonds and the redemption price paid being $24,059.55.

(b) The petitioner also reported on its income tax return for the year 1924 a profit in the sum of $24,059.55 on the purchase of the bonds referred to in paragraph 7 (a) supra.

(c) That the discount on the bonds referred to in paragraph 7 (a), supra, from date of issue to date retired is in the amount of $10,287.49 and from date retired to date of maturity $18,200.94 or a total of $28,488.43 from October 1, 1922, to maturity, October 1, 1927.

(d) That the respondent in computing the taxable profit on the purchase of the bonds referred to in paragraph 7 (a) supra reduced the profit of $24,059.55, reported by the petitioner for 1924, by $18,200.94, the unamortized discount from date retired to date of maturity, and included only a net profit of $5,858.61 in the taxable income for the year 1924 as shown in the notice of deficiency dated May 26, 1927.

16 (e) That the details of the above computation of profit are set forth in schedule " B " attached hereto and made a part of this answer.

8. That in computing the deficiency for 1924 the Commissioner applied against the net income for that year, $804,431.77, petitioner's net loss for the calendar year 1922, as determined by the Commissioner in the notice of deficiency dated May 26, 1927, in the sum of $649,077.81, in the computation of which the Commissioner included as income said difference of $26,349.06 arising out of the redemption by petitioner in 1922 of Sen Sen Chiclet Company bonds as aforesaid (par. 5 (e) to (g) of petition and answer).

9. (a) That the petitioner purchased in 1925 $684,000.00 of 6% par value notes for retirement at par which had been issued at a discount of $658,676.55.

(b) That the discount on said notes referred to in paragraph 9 (a) supra from date of issue to date retired was $14,349.73 and that the amount of unamortized discount at the time of retirement was $10,973.72.

(c) That the respondent in the audit of the return for 1925 as filed by the petitioner allowed as a deduction a loss in the amount of $10,973.72 due to the purchase and retirment of said note referred to

in paragraph 9 (a) supra and reduced taxable income for 1925 as shown in the notice of deficiency dated May 26, 1927, by said amount.

(d) That the details of the said computation of loss of $10,973.72 as set forth in schedule "C" attached hereto and made a part of this answer.

17 10. (a) That the petitioner also purchased in 1925 for retirement $275,500.00 debentures at par which had been issued at a discount of $232,950.00.

(b) That the discount on the said debentures referred to in paragraph 10 (a) supra to date retired was $25,833.93 and that the unamortized discount was $16,716.07.

(c) That the respondent in the audit of the return for 1925, as filed by petitioner, allowed as a deduction a loss in the amount of $16,716.07 due to the purchase and retirement of the debentures referred to in paragraph 10 (a) supra and reduced taxable income for 1925 as shown in the notice of deficiency dated May 26, 1927, by said amount.

(d) That the details of the said computation of loss of $16,716.07 are set forth in schedule "D" attached hereto and made a part of this answer.

11. That the petitioner's books of account and records for 1921 to 1925, inclusive, were kept on the accrual basis of accounting and its returns for the years 1921 to 1925 were filed on the same basis.

12. That if the Board finds that the Commissioner erred in respect of the assignments of error set forth in the petition (par. 4 (a)) in respect of the inclusion in taxable income for each year in dispute the difference between the maturity value (par value) and the price paid by the taxpayer in the open market for certain of its own bonds and notes, it is then affirmatively alleged that the allowance of said items of discount of $7,122.10 in 1923, referred to in paragraph 6 (c) above, $18,200.94 in 1924 referred to in paragraph

18 7 (d) above, and $10,973.72 in 1925, referred to in paragraph 9 (c) above, and $16,716.07 referred to in paragraph 10 (c) above, were erroneously allowed as a reduction and offset to the profit originally reported by the petitioner and adjusted by the respondent.

13. That the taxable income for 1923 should be further adjusted by $7,122.10, for 1924 by $18,200.94, and for 1925 by $10,973.72 plus $16,716.07 and the deficiencies proposed should be adjusted accordingly.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
BYRON M. COON,
Special Attorney,
Bureau of Internal Revenue.

19 23 B.T.A. ——

United States Board of Tax Appeals

Docket No. 29897

AMERICAN CHICLE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Findings of fact and opinion

Promulgated May 14, 1931

A corporate taxpayer which assumes the bonded indebtedness of a predecessor in business, as part consideration for its predecessor's assets and business, realizes no taxable gain from the purchase, for retirement, of its predecessor's bonds, at a price less than the face or par value of such obligations. Any and all sums paid by the petitioner for the retirement of such obligations represent payments on the purchase price of the assets and business.

A corporate taxpayer, keeping its books on an accrual basis, which has issued its own notes for a price less than their face or par value, and, during the taxable year, purchases, for retirement, a part or all of such obligations, at less than the issuing price, or the issuing price plus the total deductions for amortization, of discount allowable to the date of such purchase, is not entitled, in computing net income for the taxable year, to deduct the unamortized discount which would have been deductible in a period subsequent to
20 the date of purchase, had the notes continued to remain outstanding to the date of maturity and then had been retired at face or par value.

A corporate taxpayer, keeping its books on accrual basis, which has issued its own notes for a price less than their face or par value, and, during the taxable year, purchases, for retirement, a part or all of such obligations, at a price in excess of the issuing price plus the total deductions for amortization of discount allowable to the date of purchase, is entitled, in computing net income for the taxable year, to deduct, as an expense, the excess of the purchase price over the issuing price plus the total deductions for amortization of discount allowable to the date of purchase.

P. L. PEYTON, ESQ.,
For the Petitioner.

BYRON M. COON, ESQ.,
For the Respondent.

In this proceeding the petitioner seeks a redetermination of deficiencies in income tax, asserted by the respondent for 1924 and 1925, in the amounts of $19,419.17 and $6,674.90, respectively. The sole issue

raised in the petitioner is that the respondent erred in including in income for 1922, 1923, 1924, and 1925, as taxable gains the excess of the face or par value of certain bonds and notes, purchased for retirement in several transactions during those taxable years, over the purchase price thereof. In an amended answer, the respondent affirmatively alleges that should the Board find he erred as charged in the petition, then, he also erred in allowing as deductions for 1923, 1924, and 1925, the sums of $7,122.10, $18,200.94, and $27,689.79, respectively, for unamortized discount on the notes purchased for the retirement in those years. The case was submitted for decision on a written stipulation of facts.

21 *Findings of fact*

Petitioner is a corporation organized and existing under the laws of the State of New Jersey and has its principal office at Thomson Avenue and Manly Street, Long Island City, New York.

In 1909 the Sen Sen Chiclet Company, a Maine corporation, issued $2,700,000 face value of bonds, maturing May 14, 1929, with a sinking fund clause providing that a deposit be made with the trustee of at least $50,000 per year to provide for the purchase of bonds submitted to the trustee in open bid by bondholders under the terms of the indenture.

In August 1914 petitioner acquired all of the assets of the Sen Sen Chiclet Company and assumed the payment of its liabilities, among which were $2,425,000 par value of bonds then outstanding and unredeemed.

In 1922 petitioner purchased from the public $82,000 par value of Sen Sen Chiclet Company bonds and paid therefor $55,650.94, making a difference of $26,349.06 between the par value and the redemption price paid. The respondent, in making his determination of petitioner's net loss for the calendar year 1922, included as taxable income to petitioner for that year the difference between the par value and the redemption price paid, or $26,349.06. The petitioner reported only $16,767.50 of the $26,349.06 on the original return filed for 1922. The respondent increased this amount by $9,591.56.

On October 1, 1919, petitioner issued $2,500,000 par value of its 6 percent notes maturing serially October 1, 1920, to 1927, inclusive.

22 In October 1922 such serial notes remaining unredeemed at that time, of $1,710,000 par value, were refunded by the issuance of petitioner's five-year notes maturing October 1, 1927, in the same amount, towit: $1,710,000 par value.

The petitioner reported, on its original income-tax return filed for the year 1923, as a profit the amount of $12,428.42 on the purchase and retirement of $256,500 face value of its six percent five-year notes which were purchased for $244,071.58. The discount on these American Chicle Company six percent notes, from October 1, 1922, to date of maturity, October 1, 1927, is $9,496.14, of which $2,374.04 is discount from date of issue to date retired, and $7,122.10 is discount

from date retired to date of maturity. The respondent, in the audit of the return for the year 1923, as shown in the notice of deficiency dated May 26, 1927, reduced the amount of $12,428.42 returned as a profit on the purchase of the American Chicle Company six percent notes, by the sum of $7,122.10, the amount of discount from date of retirement to date of maturity, and determined a profit of $5,306.32.

The petitioner also reported on its original return filed for the year 1923, as a profit, the sum of $14,259.42 on the purchase of Sen Sen Chicle Company 6% bonds of a par value of $62,500 which were purchased for $48,240.58. The amount of $14,259.42 was included in income by the respondent in his determination for the year 1923.

The petitioner's net income for the calendar year 1923, as determined by the respondent in the notice of deficiency dated May 26, 1927, was $177,432.69, and the respondent applied under section 204 of the Revenue Act of 1921 against petitioner's 1923 net income, $3,917,760.86 of the net loss for 1921, as determined by him in a prior audit.

23 In 1924, petitioner purchased from the public, $15,000 par value of Sen Sen Chiclet Company bonds and paid therefor $11,391 and the trustee of the sinking fund also purchased from the public in the year 1924, $44,000 par value of the Sen Sen Chiclet Company bonds, paying therefor $36,211.10, the difference between the par value of such bonds and the redemption prices paid being the amount of $11,397.90. The petitioner reported, on its income-tax return filed for the year 1924, as a profit, the amount of $11,397.90 on the purchase of the Sen Sen Chiclet Company 6% bonds. The respondent, in the audit of this return, as shown in the deficiency notice dated May 26, 1927, included the amount of $11,397.90 in the taxable income for 1924.

In 1924 petitioner also purchased from the public $769,500 par value of its five-year notes and paid therefor the sum of $745,440.45, the difference between the par value of said notes and the redemption price paid being $24,059.55. The petitioner also reported this amount as profit in its return for the year 1924. The discount on these notes from date of issue to date retired is in the amount of $10,287.49, and from date retired to date of maturity $18,200.94; or a total of $28,488.43 from October 1, 1922, to maturity, October 1, 1927. The respondent, in computing the taxable profit on the purchase of these notes, reduced the amount of $24,059.55 reported by petitioner as a profit for 1924, by the sum of $18,200.04, the unamortized discount from date retired to date of maturity, and included only a net amount of $5,858.61 in the taxable income for the year 1924, as shown in the deficiency notice dated May 26, 1927.

In computing the deficiency for 1924, the respondent ap-
24 plied against the net income of $804,431.17 for that year petitioner's net loss for the calendar year 1922, as determined by the respondent, in the deficiency notice dated May 26, 1927, in the sum of $649,077.81. In the computation of said net loss for

1922 the respondent included as income said difference of $26,349.06 arising out of redemption by petitioner in 1922 of Sen Sen Chiclet Company bonds.

Petitioner, in 1925, purchased $166,500 par value of Sen Sen Chiclet Company bonds from the public and paid therefor $152,016.81, and the trustee of the sinking fund likewise purchased from the public $35,000 par value of Sen Sen Chiclet Company bonds and paid therefor $34,129.50, the difference between the par value of the bonds and the redemption prices paid therefor being $15,353.69. The petitioner reported on its income tax return filed for the year 1925, as a profit on the purchase of these bonds, the amount of $15,353.69, which the respondent included as income in his determination for the year 1925.

In 1925 the petitioner purchased at par for retirement $684,000 of its 6% notes which had been issued at a discount for $658,676.55. The discount on these notes from date of issue to date retired was $14,349.73, and the amount of unamortized discount at the date retired was $10 973.72. The respondent, in his determination of deficiency, allowed as a deduction from income a loss in the amount of $10,973.72 due to the purchase and retirement of these notes.

The petitioner also purchased in 1925, for reirement, $275,500 debentures at par which had been issued at a discount for $232,950.
The discount on these debentures to date of retirement was
25 $25,833.93, and the unamortized discount was $16,716,07. The respondent, in his determination of the deficiency for 1925, allowed as a deduction a loss in the amount of $16,716.07 due to the purchase and retirement of those debentures.

The petitioner's books of account and records for 1921 to 1925, inclusive, are kept on the accrual basis of accounting and its returns for those years were filed on the same basis.

Opinion

McMAHON: The tax liabilities of the petitioner for the years 1921, 1922, and 1923 are not before us for redetermination, but we are concerned with any net losses sustained by the petitioner in those years insofar as they effect the petitioner's tax liability for the year 1924. Since the net loss for 1921 exceeds the net income for 1923 and the petitioner sustained a net loss for 1922, the adjudication of the issues as they relate to 1923 would not change the amount of the net loss for 1922 which the petitioner is entitled to deduct, under section 206 (e) of the Revenue Act of 1924, in computing net income for 1924. We will, therefore, not consider the issues insofar as they relate to the year 1923.

The respondent has charged the petitioner with income in 1922, 1924, and 1925 in the amounts of $26,849.06, $11,397.90, and $15,353.69, representing, in each instance, the amount by which the face or par value of the Sen Sen Chiclet Company 6% bonds, purchased for

retirement during the year, exceeded the purchase price paid by the petitioner. The bonds in question were a part of the bonds of the Sen Sen Chiclet Co. outstanding at the date of the purchase of that company's assets by the petitioner, payment of which was assumed by the petitioner as part of the purchase price of those
26 assets. Potentially, the liability created by the petitioner in assuming the payment of these bonds was equal to their aggregate face or par value, but its actual liability to the Sen Sen Chiclet Co. was not for any specific sum, but, rather, one which could be satisfied by whatever amount the petitioner might be required to pay in acquiring the bonds for retirement. There is not here, therefore, in fact, as both parties have assumed, a matter of the petitioner's satisfaction of an obligation for less than the full amount or face value thereof. The payments involved in the transactions under consideration were payments on the purchase price of the Sen Sen Chiclet Company's assets, paid, under the conditions of the agreement, to the holders of that company's bonds. When all of the bonds have been retired by the petitioner its obligation to the Sen Sen Chiclet Company will have been satisfied in full, and whatever the total amount paid to retire the bonds, it will constitute a part of the cost to petitioner of the Sen Sen Chiclet Co. assets. Accordingly, we hold that the petitioner derived no income in 1922, 1924, and 1925 from the purchase of the Sen Sen Chiclet Co. bonds, for retirement, at a price less than the face or par value of such bonds, and that the respondent erred in including in income for those years the items of $26,349.06, $11,397.90 and $15,353.69, respectively. See New York, Chicago & St. Louis Railroad Co., 23 B.T.A.—

The petitioner further complains against the respondent's action in charging it with income in 1924 in the amount of $24,059.56, representing the amount by which the face or par value of the petitioner's notes purchased for retirement during the year ex-
27 ceeded the purchase price paid by the petitioner. Against this item of $24,059.55 the respondent allowed an offset of $18,200.94, representing the so-called "unamortized discount" on these notes at the date of purchase and retirement, so that the net amount which the respondent has included in income is $5,858.61. The respondent denies the error charged in the complaint, and counters with an affirmative allegation that if the petitioner prevails as to the item of $24,059.55, the offsetting item of $18,200.94 should to eliminate from the computation of net income, and, further, that he erred in allowing a deduction for 1926 of $27,689.79 for unamortized discount on the notes and debentures purchased for retirement in that year. We understand that wherever the term "discount" has been used in the stipulation of facts the parties used the term to mean the difference between the issuing price of the petitioner's obligations, for cash, and the face or par value thereof, which brings it within the definition of "discount" as stated in New York, Chicago & St. Louis Railroad Co., supra.

Following the principle laid down in Bowers v. Kerbaugh-Empire Co., 271 U.S. 170, the Board has repeatedly held, in a long line of cases, that a corporate taxpayer realizes no taxable gain from the purchase of its own bonds at less than the issuing price. See American Tobacco Co., 20 B.T.A. 586, and cases therein cited. The facts of this case require the application of the same rule. However, the item of $18,200.94, which the respondent has allowed as an offset against the alleged gain of $24,059.55, for "unamortized discount" on the notes retired in 1924, should be eliminated from the computation of net income for that year, since it is clear that any
28 such discount was not actually paid upon retirement of the notes. These notes, having a face or par value of $769,500, had been issued for $741,011.57 and were purchased by the petitioner at the price of $745,440.45. Thus, the discount which the petitioner actually paid amounted to only $4,428.88. The discount amortized to the date of purchase, which the petitioner was entitled to take as deductions in returns of prior years, to wit: $10,287.49, was almost twice as great as the discount which the petitioner actually paid. Clearly, under these facts, the petitioner was not entitled to any further allowance in respect of the discount on these notes when they were purchased for retirement in 1924. Accordingly, we hold that the net income for 1924, as determined in the deficiency notice, should be reduced by the sum of $5,858.61.

However, we hold that the respondent correctly allowed a deduction of $27,689.79 for 1925 in connection with the purchase and retirement of certain notes and debentures in that year. These notes and debentures, having an aggregate face or par value of $959,500, had been issued for $891,626.55, and were purchased by the petitioner at par. The amortized discount on these obligations to the date of the purchase, which the petitioner, keeping its books on an accrual basis, was entitled to deduct in its returns amounted to $40,183.66. Article 545 (3) of Regulations 69 provides:

(a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. "(b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already
29 deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any discount not yet deducted) is a deductible expense for the taxable year. * * *"

The petitioner purchased and retired the notes and debentures at a price which exceeded, by $27,689.79, the issuing price plus the amortized discount which the petitioner was entitled to deduct in its returns; and under the foregoing provisions of the regulations, which we believe to be a fair and reasonable interpretation of the applicable statute, it was entitled to the deduction of $27,689.79 which the respondent has allowed.

In view of the conclusions reached in this opinion, the net incomes for 1924 and 1925, as determined by the respondent in the deficiency notices, should be reduced by the amounts of $43,605.57 and $15,353.69, respectively.

Reviewed by the Board.

Judgment will be entered under rule 50.

30 Before United States Board of Tax Appeals, Washington

Docket No. 29897

AMERICAN CHICLE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision entered July 29, 1931

Pursuant to findings of fact and opinion promulgated May 14, 1931, the respondent herein, to wit, on July 10, 1931, having filed a proposed redetermination for the years 1924 and 1925, and the petitioner on July 22, 1931, having filed notice of acquiescence to the said proposed redetermination, it is

Ordered and decided that there is a deficiency for the year 1924 in the amount of $2,275.11; and that there is no deficiency and no overpayment for the year 1925.

Entered.

(Signed) CHARLES P. SMITH,
Member.

Enter Jul. 29, 1931.
vlh

31 Before United States Board of Tax Appeals

[Title omitted.]

Petition for rehearing

Now comes the Commissioner of Internal Revenue, by his attorney, C. M. Charest, general counsel, Bureau of Internal Revenue, and

Moves that the decision of the Board in the above-entitled appeal, promulgated on May 14, 1931 (23 B.T.A. 221), be reconsidered and partly reversed, the final order therein of July 29, 1931, be vacated, and judgment rendered in accordance with the Board's revised decision.

The Board in its decision of May 14, 1931 held—

1. That as a result of the acquisition by the petitioner for retirement of its predecessor's bonds at a price less than the par value of such obligations which had been assumed as a part consideration for its predecessor's assets and business there was no taxable gain.

2. That as a result of its acquisition by the petitioner for retirement of its own notes at a price less than the issuing price, or the issuing price plus the total deductions there was no taxable gain.

32 The facts are fully set forth in the Board's "findings of fact" upon which it based its opinion promulgated May 14, 1931.

In arriving at its conclusion that the amount by which the face or par value of the Sen Sen Chiclet Company's 6% bonds purchased for retirement exceeded the purchase price paid by the petitioner was not taxable gain, and that the amount by which the face or par value of the petitioner's notes purchased for retirement exceeded the purchase price paid by the petitioner was not taxable gain, the Board followed in the wake of its own decisions based upon its interpretation of Bowers v. Kerbaugh-Empire Co., 271 U.S. 170, namely, New York, Chicago and St. Louis Railroad Co., 23 B.T.A. 256 and American Tobacco Company, 20 B.T.A. 586.

However, since the Board decided the instant case, the United States Supreme Court settled the principle herein involved on November 2, 1931, in the case of United States v. Kirby Lumber Co. (C.C.H. 9156; Prent. Hall 2300.93).

In the Kirby Lumber Company case the Supreme Court reversed the Court of Claims' decision (44 Fed. (2d) 885) and held that where a corporation purchases and retires its own bonds at a price less than the issuing or face value, the excess of the issuing price or face value over the purchase price is taxable income for the taxable year. It distinguished the point decided in the Kirby Lumber Company case from that decided in the Kerbaugh-Empire Company case.

Wherefore, the premises considered, it is respectfully prayed that the Board grant this motion, reverse in the respects above set forth

33 the decision promulgated May 14, 1931, vacate its final order of July 29, 1931 entered thereunder, and render judgment for the respondent in accordance with the Board's modified decision without prejudice to the rights of the parties to contest the correctness of the opinion pursuant to the statutes in such cases made and provided.

(Signed) C. M. CHAREST,
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of counsel:
BYRON M. COON,
Special Attorney,
Bureau of Internal Revenue.

Before United States Board of Tax Appeals

[Title omitted.]

Notice of filing and hearing motion

Dec. 9, 1931

Please take notice the respondent has filed a motion in the above-entitled proceeding, a copy of which is inclosed herewith.

34 This motion has been placed on the Day Calendar for hearing before a division of the Board at its Washington office, Constitution Avenue at 12th Street Northwest, at 9:30 a.m. on Dec. 16, 1931.

No further notice of this hearing will be sent.

B. D. GAMBLE, *Clerk.*

To: P. L. PEYTON, Esq.,
15 Broad St., New York, N.Y.

Before United States Board of Tax Appeals

[Title omitted.]

Order reversing and modifying opinion

The Board having promulgated its opinion in the above-entitled proceeding on May 14, 1931, wherein it was held that the petitioner did not realize income in the year 1924 in the amount of $5,858.61 by virtue of the retirement by petitioner of certain of its own notes at less than the issuing price thereof plus the total deductions for amortization of discount allowable to date of retirement, and that the petitioner did not realize income in the years 1922, 1924, and 1925 in the amounts of $26349.06, $11,397.90, and $15,353.69, respec-

35 tively, from the retirement, at less than face or par value, of Sen Sen Chiclet Company 6 percent bonds, payment of which was assumed by the petitioner at the time petitioner obtained the assets of the Sen Sen Chiclet Company; the Board having entered its decision in this proceeding on July 29, 1931, setting forth a deficiency of $2,275.11 for the year 1924 and no deficiency and no overpayment for the year 1925; the respondent having filed, on December 8, 1931, within the six months period provided for by statute for the filing of a petition for review, a petition for rehearing wherein it was moved that the Board reverse such holdings set forth above, respondent relying upon the decision of the United States Supreme Court in United States v. Kirby Lumber Company, ————; hearing having been duly had upon such motion on December 16, 1931, at which time counsel for petitioner conceded that under the decision in United States v. Kirby Lumber Company, supra, petitioner realized a gain of $5,858.61 in 1924 upon the purchase of its own notes and that such

amount is taxable income for that year, but denied that it derived taxable income from the retirement of Sen Sen Chiclet Company bonds; now, therefore, the motion having been duly considered, it is

Ordered: that the opinion of the Board in this proceeding promulgated May 14, 1931, should be and the same hereby is reversed and modified to hold that the amount of $5,858.61 constituted taxable income to the petitioner in the year 1924; that the decision entered in this proceeding on July 29, 1931, be and the same hereby is vacated and set aside; and that the respondent's petition for rehearing
36 in so far as it requests that the Board hold and decide that the above referred to amounts of $26,349.06, $11,397.90, and $15,353.69 constituted income to the petitioner in the years 1922, 1924, and 1925, respectively, be, and the same hereby, is denied. (See New York, Chicago & St. Louis Railroad Co., 23 B.T.A. 177, cited in the opinion promulgated in this proceeding; and Athol Manufacturing Co. v. Commissioner, decided by the United States Circuit Court of Appeals, First Circuit, December 17, 1931); and it is further

Ordered that the proceeding be restored to the day calendar of February 17, 1932, on or before which date the parties shall file recomputations of the deficiencies in accordance herewith.

(Signed) STEPHEN J. MCMAHON,
Member, U.S. Board of Tax Appeals.

Entered Jan. 26, 1932.

Before United States Board of Tax Appeals

Docket No. 29897

AMERICAN CHICLE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision Entered February 23, 1932

Pursuant to the opinion of the Board promulgated on May 14, 1931, and to the order entered January 26, 1932, in the above-
37 entitled proceeding, counsel for the petitioner having filed a proposed final determination with notice of settlement, and at the hearing under rule 50 had on February 17, 1932, counsel for the respondent having interposed no objection to such proposed final determination, now therefore, it is

Ordered and decided that with respect to the year 1924 there is a deficiency in tax in the amount of $3,007.44, and that with respect to the year 1925 there is no deficiency.

(Signed) STEPHEN J. MCMAHON,
Member U.S. Board of Tax Appeals.

Entered Feb. 23, 1932.

Before United States Board of Tax Appeals

[Title omitted.]

Motion for reconsideration and modification of decision

Now comes the Commissioner of Internal Revenue, by his attorney, C. M. Charest, general counsel, Bureau of Internal Revenue, and

Moves that the order of this Board, entered in this appeal
38 on January 26, 1932, and the decision based thereon, entered on February 23, 1932, be reconsidered and modified insofar as such order and decision deny the respondent's contention that the petitioner received taxable gain or profit as the result of the purchases for retirement of outstanding bonds issued by the Sen Sen Chiclet Company, the predecessor corporation. which obligations the petitioner had assumed and agreed to pay as part consideration for the transfer to it of all of the assets of the said Sen Sen Chiclet Company.

The Board supports its conclusion that the petitioner derived no taxable gain from its purchase and retirement of the Sen Sen Chiclet bonds by citing its decision in the Appeal of the New York, Chicago & St. Louis Railroad Co., 23 B.T.A. 177, and the Appeal of the Athol Manufacturing Co., 22 B.T.A. 105, affirmed by C.C.A., 1st Ct., 54 Fed. (2d) 230.

However, the railroad case, supra, involved the purchase and retirement of bonds issued by the taxpayer, the same as in the Kirby Lumber Co. case, 284 U.S. 1, wherein the Supreme Court decided that a taxable gain resulted. Moreover, the Board has modified its decision in the New York, Chicago & St. Louis Railroad Co. case, supra, by taxing as gain the difference between the issuing price and the recovery price of the bonds after respective counsel therein had agreed that the principle decided in the Kirby Lumber case was applicable.

The Appeal of the Athol Manufacturing Company, supra, presented an entirely different question than the one in the instant case. The Athol Manufacturing Company made payments
39 from time to time on certain debts of its predecessor which it had assumed and agreed to pay as a consideration for the transfer to it of the predecessor's assets and attempted to take deductions therefor from its income as business expense. There was no question of gain resulting from dicounts or compromises of the debts. So, the Athol Manufacturing Co. case, supra, is not authority for the Board's decision that there was not taxable gain from the petitioner's advantageous purchase of the Sen Sen Chiclet Company's bonds.

The Board has applied the Kirby Lumber Company case, supra, to the purchases by the petitioner of its own bonds, but does not recognize its applicability to the purchases by the petitioner of its

predecessor's bonds. There is no material difference in the subject matter of the two transactions.

In both instances the bonds were the obligations of the petitioner and the assets affected were the petitioner's. The bonds executed by the Sen Sen Chiclet Company had been assumed by the petitioner in consideration of transferred assets. The petitioner stood in the shoes of the Sen Sen Chiclet Company.

It is true that the amounts of the bonds of the Sen Sen Chiclet Company in the first instance constituted part of the cost of the petitioner's assets. So did the bond issued by the petitioner add to the cost of its assets. The advantage to the petitioner was as real, substantial, and material in one case as in the other. It is not apparent why a different principle or rule of law should apply in one case than that applicable to the other.

Wherefore, the respondent renews its motion that the Board reconsider its order and decision heretofore made herein, and
40 modify it, in so far as it relates to the Sen Sen Chiclet Company bonds and hold that the purchases thereof at least than par value resulted in taxable gain.

(Signed) C. M. CHAREST,
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of counsel:
B. M. COON,
Special Attorney,
Bureau of Internal Revenue.

BMC/mer.
3/9/32.

Before United States Board of Tax Appeals

[Title omitted.]

Order denying motion for reconsideration, etc.

The Board having promulgated its opinion in the above-entitled proceeding on May 14, 1931, wherein it was held that the petitioner did not realize income in the year 1924 in the amount of $5,858.61 by virtue of the retirement by petitioner of certain of its own
41 notes at less than the issuing price thereof plus the total deductions for amortization of discount allowable to date of retirement and that the petitioner did not realize income in the years 1922, 1924, and 1925 in the amounts of $26,349.06, $11,397.90, and $15,353.69, respectively, from the retirement, at less than face or par value, of Sen Sen Chiclet Company 6 percent bonds, payment of which was assumed by the petitioner at the time petitioner obtained the assets of the Sen Sen Chiclet Company; the Board having entered its decision in this proceeding on July 29, 1931, setting forth a de-

ficiency of $2,275.11 for the year 1924 and no deficiency and no overpayment for the year 1925; the respondent having filed on December 8, 1931, within the six months' period provided for by statute for the filing of a petition for review, a petition for rehearing wherein it was moved that the Board reverse such holdings set forth above, respondent relying upon the decision of the United States Supreme Court in United States v. Kirby Lumber Company, 284 U.S. 1; hearing having been duly had upon such motion on December 16, 1931, at which time counsel for petitioner conceded that under the decision in United States v. Kirby Lumber Company, supra, petitioner realized a gain of $5,858.61 in 1924 upon the purchase of its own notes and that such amount is taxable income for that year, but denied that it derived taxable income from the retirement of Sen Sen Chiclet Company bonds; the Board having entered an order on January 26, 1932, holding that the petitioner realized taxable income in the amount of $5,858.61 upon the retirement of its own notes but that petitioner did not realize taxable income upon the retirement of bonds of the Sen Sen Chiclet Company; the Board having promulgated its decision on February

42 23, 1932, that for the year 1924 there is a deficiency in tax in the amount of $3,007.44, and that with respect to the year 1925 there is no deficiency; counsel for respondent having filed on March 10, 1932, a "motion for reconsideration and modification of decision" wherein the respondent renews its motion that the Board hold that the retirement by the petitioner of the bonds of the Sen Sen Chiclet Company resulted in taxable gain; now, therefore, the premises having been duly considered, it is

Ordered that such motion be and the same hereby is denied. (See memorandum attached.)

(Signed) STEPHEN J. MCMAHON,
Member.

Entered: July 12, 1932.

Before United States Board of Tax Appeals

[Title omitted.]

Memorandum

The respondent in support of his "motion for reconsideration and modification of decision" which was filed on March 10, 1932,

43 points to the modification of the opinion in New York, Chicago & St. Louis Railway Company, 23 B.T.A. 177, which was relied upon in the instant proceeding. In that case the modification was entered in accordance with a stipulation entered into between the parties to the effect that United States v. Kirby Lumber Co., 284 U.S. 1, required a holding that the taxpayer in 1917 had a gain of $16,958.34 from the purchase of its bonds for less than par. In the instant proceeding that modification which was made in that

proceeding in accordance with the stipulation of those parties, is not binding; and in the instant proceeding the principle that the Sen Sen Chiclet Company bonds were assumed by the petitioner as a part of the purchase price of the assets of the Sen Sen Chiclet Company, and that whatever petitioner is required to pay to retire the Sen Sen Chiclet Company bonds constitutes a part of the cost to the petitioner of the Sen Sen Chiclet Company assets is adhered to. The principle relied upon here is that enunciated in Athol Manufacturing Co., 22 B.T.A. 105, affirmed 54 Fed. (2d) 230, wherein it is stated in part as follows:

"The petitioner further contends that it is entitled to deduct certain amounts paid out by it in 1923 and 1924 upon the obligations of the old company. Since, however, the petitioner assumed these obligations of the old company as part consideration for the purchase of its assets, it is apparent that the amounts paid out upon such obligations are a part of the cost to the petitioner of the assets and constitute capital rather than business items, as the respondent has determined. * * * *"

44 It is held that the petitioner derived no income in 1922, 1924, and 1925 from the purchase of the Sen Sen Chiclet Company bonds.

(Signed) STEPHEN J. MCMAHON,
Member.

In United States Circuit Court of Appeals, Second Circuit

[Title omitted.]

Petition for Review and Assignment of Error

To the Honorable Judges of the United States Circuit Court of Appeals for the Second Circuit:

Now comes David Burnet, Commissioner of Internal Revenue, by his attorneys, G. A. Youngquist, Assistant Attorney General, C. M. Charest, general counsel, Bureau of Internal Revenue, and Byron M. Coon, special attorney, Bureau of Internal Revenue, and resepectfully shows:

I

45 The petitioner on review is the duly appointed and qualified Commissioner of Internal Revenue, holding his office by virtue of the laws of the United States. The respondent on review, the taxpayer, is a corporation duly organized and existing under and by virtue of the laws of the State of New Jersey having its principal office in Long Island City, New York; that it filed its corporate income and profits tax returns for the calendar years 1924 and 1925 with the Collector of Internal Revenue in the First Collection District of New York, whose office is located within the jurisdiction of the United States Circuit Court of Appeals for the Second Circuit.

II

The Commissioner of Internal Revenue determined deficiencies in income taxes for the calendar years 1924 and 1925 in the amounts of $19,419.17 and $8,674.90, respectively, and on May 26, 1927, in accordance with the provisions of subdivision (a) of section 274 of the Revenue Act of 1926, sent the respondent herein by registered mail a notice of said deficiencies. Thereafter the taxpayer appealed said notice of deficiency to the United States Board of Tax Appeals, and said appeal bears docket number 29897. On May 14, 1931, the Board promulgated its interlocutory decision containing its findings of facts and opinion, reported in 23 B.T.A. 221. On July 29, 1931, the Board entered its order of redetermination, wherein it ordered and decided that there was a deficiency of $2,275.11 for the year 1924 and no deficiency and no overpayment for the year 1925. On December 8, 1931, within the six-months period provided for by statute for the filing of a petition for review, a petition for rehearing was filed by the Commissioner and heard on December 16, 1931, at
46 which hearing the taxpayer conceded the taxability of its gain derived from the purchase for retirement of its own notes at less than the issuing price, but continued to deny the taxability of similar gains from its predecessor's bonds which it had assumed. On January 26, 1932, the Board entered its order holding that the taxpayer realized taxable income in the amount of $5,858.61 upon the retirement of its own notes, but that the taxpayer did not realize taxable income upon the retirement of the bonds of its predecessor company; and on February 23, 1932, the Board promulgated its decision that there was a deficiency in the amount of $3,007.44 for the year 1924, and that with respect to the year 1925 there was no deficiency.

On March 10, 1932, the Commissioner filed a motion for reconsideration and modification of the Board's decision, and on July 16, 1932, the Board made and entered its memorandum opinion and order denying the said motion.

The tax liability of the respondent for the years 1921, 1922, and 1923 were not before the Board for redetermination, but the Board was concerned with any net losses sustained by the respondent in those years insofar as they affected its tax liability for the year 1924.

The question in the case is whether the Commissioner erred in including in the taxpayer's income for the years 1922, 1924, and 1925 as taxable gain the excess of the face or par value over the purchase price of certain bonds of the Sen Sen Chiclet Company which the taxpayer assumed and agreed to pay when it acquired the assets of the Chiclet Company, which bonds were purchased for retirement in several transactions during those years.

47 In 1909 the Sen Sen Chiclet Company, a Maine corporation, issued $2,700,000 face value of bonds maturing May 14, 1929,

with a sinking-fund clause providing for a deposit with the trustee of $50,000 a year to provide for the purchase of bonds submitted to the trustee in open bid by bondholders under the terms of the indenture. In August 1914 the respondent acquired all of the assets of the Sen Sen Chiclet Company and assumed the payment of its liabilities, among which was $2,425,000 par value of bonds then outstanding and unredeemed. Thereafter the respondent purchased from the public Sen Sen Chiclet bonds and paid therefor as follows:

In 1922, $82,000 par value for $55,650.94, thereby saving $26,349.06, of which $16,787.50 was reported as income by the taxpayer and the entire amount included in the taxable income by the Commissioner.

In 1923, $62,500.00 par value bonds for $47,240.58, thereby saving $14,259.42, which was reported by the taxpayer and included therein by the Commissioner.

In 1924, $57,000 par value Sen Sen Chiclet Company bonds for $47,602.10, thereby saving $11,397.90, which was reported by the taxpayer as income and included therein by the Commissioner.

In 1925, $201,500 par value bonds for $186,146.31, thereby saving $15,353.69, which was reported as income by the taxpayer and included in income by the Commissioner.

The Board excluded all of said items from income.

The petitioner charged the respondent herein with income in 1922, 1924, and 1925 in the amounts of $26,349.06, $11,397.90, and $15,353.69, representing in each instance the amount by
48 which the face or par value of the Sen Sen Chiclet Company bonds purchased for retirement during the year exceeded the purchase price paid by the petitioner. The bonds in question were a part of the bonds of the Sen Sen Chiclet Company outstanding at the date of the purchase of that company's assets by the respondent, payment of which was assumed by the respondent as part of the purchase price of these assets.

The Board reasoned that although potentially the liability created by the respondent in assuming the payment of the bonds was equal to their aggregate face or par value, yet actually its liability to the Sen Sen Chiclet Company was not for any specific sum, but rather one which could be satisfied by whatever amount the respondent might be required to pay in acquiring the bonds for retirement. Therefore, it appeared to the Board that there was not in the case a matter of the respondent's satisfaction of an obligation for less than the full amount or face value thereof, but rather that whatever amounts the respondent paid to acquire the bonds for retirement constituted items of cost of the assets of the Sen Sen Chiclet Company, and the amounts the respondent avoided payment of in acquiring said Sen Sen Chiclet Company's bonds at less than par did not constitute taxable gain.

Accordingly, the Board held that the petitioner erred in including in income for the years 1922, 1924, and 1925 the said amounts of

$26,349.06, $11,397.90, and $15,353.69, respectively, on account of the purchase of said bonds and notes, and that the net incomes of the respondent herein for the years 1924 and 1925 as determined by the petitioner in the deficiency notices should be reduced by the amounts of $11,397.90 and $15,353.69, respectively.

49

III

Your petitioner further shows that he is aggrieved by the action of the said Board and injured thereby and that the errors complained of are as follows:

1. The Board of Tax Appeals erred in deciding and determining that the Commissioner erred in including in income for the year 1922, 1924, and 1925, respectively, the amounts of $26,349.06, $11,397.80, and $15,353.69, respectively.

2. The Board of Tax Appeals erred in deciding and determining that the difference between the par or face value of the said Sen Sen Chiclet Company bonds and the cost of acquisition for retirement was not taxable gain.

3. The Board of Tax Appeals erred in refusing to increase the taxpayer's income for the years 1922, 1924, and 1925, in the amounts of $26,349.06, $11,397.90, and $15,353.69, respectively.

4. The Board of Tax Appeals erred in refusing to reverse and modify its holding that the said difference between the par value and the purchasing price of the said Sen Sen Chiclet bonds was not taxable income.

5. The Board of Tax Appeals erred in holding and deciding that the said differences and gains in the purchase of the said Sen Sen Chiclet Company's bonds for retirement did not constitute a part of the cost to the taxpayer of the Sen Sen Chiclet Company assets.

Wherefore, the Commissioner petitions that the decisions and orders of the Board of Tax Appeals be reviewed by the United

50 States Circuit Court of Appeals for the Second Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said court and transmitted to the clerk of the said court for filing and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by the said court.

G. A. YOUNGQUIST,
Assistant Attorney General.
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of counsel:
BYRON M. COON,
Special Attorney,
Bureau of Internal Revenue.

(Verified by C. M. Charest on August 19, 1932.)

51 In United States Circuit Court of Appeals

[Title omitted.]

Notice of filing petition for review

To: AMERICAN CHICLE COMPANY,
Long Island City, New York.
PAUL L. PEYTON,
% BREED, ABBOTT & MORGAN,
15 Broad Street, New York, N.Y.

You are hereby notified that the Commissioner of Internal Revenue did, on the 19th day of August 1932, file with the clerk of the United States Board of Tax Appeals, at Washington, D.C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review
52 and the assignments of error as filed is hereto attached and served upon you.

Dated this 19th day of August 1932.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 22 day of August 1932.

(Sgd.) AMERICAN CHICLE CO.,
A. A. MASTERSON,
Respondent on Review.

(Sgd.) PAUL L. PEYTON,
Attorney for Respondent on Review.

53 In United States Circuit Court of Appeals

[Title omitted.]

Praecipe for record

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the clerk of the United States Circuit Court of Appeals for the Second Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Second Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board.

(a) Petition, including annexed copy of deficiency letter.
(b) Answer.

(c) Amendment to answer.

(d) Petition for rehearing filed December 8, 1931.

54 (e) Motion for reconsideration filed March 10, 1932.

3. Findings of fact, opinion and decision of the Board.

(a) Order entered January 26, 1932, decision entered Feb. 23, 1932.

(b) Memorandum decision entered July 12, 1932.

4. Notice of hearing of petition for rehearing.

5. Petition for review, together with proof of service of notice of filing petition for review and of service of copy of petition for review.

6. Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record.

7. This praecipe.

(Signed) C. M. CHAREST.
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this 19th day of November 1932.

PAUL L. PEYTON,
Attorney for Respondent.

55 [Clerk's certificate to foregoing transcript omitted in printing.]

56 In United States Circuit Court of Appeals for the Second Circuit

No. 380. October Term, 1932

Argued April 21, 1933. Decided May 8, 1933

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

AMERICAN CHICLE COMPANY, RESPONDENT

Appeal from the United States Board of Tax Appeals.

Before L. HAND, SWAN, and CHASE, Circuit Judges.

Appeal by the Commissioner of Internal Revenue from an order of the Board of Tax Appeals expunging in part a deficiency assessed against the American Chicle Company.

William Cutler Thompson, of Washington, D.C., for petitioner.

Paul L. Peyton, of Bronxville, N.Y., for respondent.

Opinion

PER CURIAM:

The question presented by this appeal arises as follows: In 1914 the taxpayer, which keeps its books on an accrual basis, bought all the

assets of another company, and assumed its debts. These included an issue of bonds which provided for an annual amortization by purchase in the market. In the years 1924 and 1925, the taxpayer, in accordance with its obligation bought a number of these bonds at less than their face and so retired them. The Commissioner charged it, as present income, with the difference between the face of these bonds and the amount at which they were bought. The taxpayer appealed, the Board expunged this part of the deficiency, and the Commissioner in turn appealed to this court.

The question depends for its answer upon the scope of the decision of the Supreme Court in United States v. Kirby Lumber Co., 284 U.S. 1, 52 S.Ct. 4, 76 L.Ed. 131, where it was held that such a profit was income, in a case where the bonds had been issued by the taxpayer for money, and been bought and retired in the same year. The first circuit in Commissioner v. Coastwise Transportation Co. (C.C.A.) 62 F. (2d) 332, extended the doctrine to a case where the taxpayer had bought a fleet of ships, for which it gave in part payment a series of notes secured by a mortgage on the fleet. Some of these it retired at less than par. Later it refunded the notes by a bond issue, some of which it also retired at less than par. As to both it was charged with the difference as income. These are the only decisions in the courts which have dealt with the question. However, since 1921 the Commissioner's regulations (now article 545, Regulations 69), have provided that although, "if bonds are issued * * * at their face value, the corporation realizes no gain or loss", it does so upon their retirement at less than their "face value." This was the regulation approved in United States v. Kirby Lumber Company. Athol Mfg. Co. v. Com'r., 54 F. (2d) 230 (C.C.A. 1), and Commissioner of Internal Revenue v. Rail Joint Co., 61 F. (2d) 751 (C.C.A. 2), do not touch the question at bar at all.

We can see no difference between bonds retired in the same year and later; nor between those issued in payment for property, and an existing mortgage assumed by the buyer when the property is transferred. But the distinction does seem to us critical between obligations whose consideration is money, and those issued or assumed for property which the obligor still holds. Every increase in the value of property might indeed be treated as a "gain", though
57 that would involve appraising taxpayers' property each year; but such is not the notion underlying our system of taxation. The gain must be "realized", either by a sale of the property for money, or by its exchange for something else. Section 935, title 26, U.S. Code (26 U.S.C.A. § 935). When a taxpayer gets money by issuing an obligation which he later discharges for less than its face, the transaction is completed, because money need not be sold or exchanged to be "realized." So we read United States v. Kirby Lumber Co., supra, 284 U.S. 1, 52 S.Ct. 4, 76 L.Ed. 131. But if he buys property by an obligation in the form of a bond, note, or the like, and if it remains in kind after the debt is paid, there can be no

"gain." The cost has indeed been definitively settled, but that is only one term of the equation; as long as the other remains at large, there is no "realized" gain.

Order affirmed.

58 In United States Circuit Court of Appeals, Second Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

AMERICAN CHICLE COMPANY, RESPONDENT

Judgment

Filed May 15, 1933

Appeal from the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be, and it hereby is, affirmed.

It is further ordered that a mandate issue to the said Board in accordance with this decree.

WM. PARKIN, *Clerk.*

59 [File endorsement omitted.]

60 [Clerk's certificate to foregoing transcript omitted in printing.]

61 Supreme Court of the United States

Order allowing certiorari

Filed October 9, 1933

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Endorsement on cover:) File No. 37,952. U.S. Circuit Court of Appeals, Second Circuit. Term No. 349. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, vs. American Chicle Company. Petition for a writ of certiorari and exhibit thereto. Filed August 15, 1933. File No. 349 O.T. 1933.

U. S. GOVERNMENT PRINTING OFFICE: 1933

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes and regulations involved	2
Statement	2
Specification of errors to be urged	4
Reasons for granting the writ	4
Appendix	10

CITATIONS

Cases:

Burnet v. *Sanford & Brooks Co.*, 282 U.S. 359 — 7

Charleston & W. C. R. Co. v. *Burnet*, 50 F. (2d) 342 — 6

Chicago, R. I. & P. Ry. Co. v. *Commissioner*, 47 F. (2d) 990, certiorari denied, 284 U.S. 618 — 6

Coastwise Transportation Corp. v. *Commissioner*, B.T.A., decided July 21, 1933 — 8

Commissioner v. *Coastwise Transp. Corp.*, 62 F. (2d) 332 — 7, 8

United States v. *Kirby Lumber Co.*, 284 U.S. 1 — 4, 5, 7, 8, 9

Statutes:

Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 254:

Sec. 213 — 10

Sec. 233 — 10

Revenue Act of 1924, c. 234, 43 Stat. 253:

Sec. 213 (U.S.C., Title 26, Sec. 954) — 10

Sec. 233 (U.S.C., Title 26, Sec. 985) — 10

Revenue Act of 1926, c. 27, 44 Stat. 9

Sec. 213 (U.S.C. App., Title 26, Sec. 954) — 10

Sec. 233 (U.S.C. App., Title 26, Sec. 985) — 10

Miscellaneous:

Regulations 62, Art. 545 — 11

Regulations 65, Art. 545 — 11

Regulations 69, Art. 545 — 11

In the Supreme Court of the United States

OCTOBER TERM, 1933

No. —

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

AMERICAN CHICLE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General on behalf of David Burnet, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above cause on May 15, 1933, affirming the decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 19–29) is reported in 23 B.T.A. 221. A memorandum opinion (R. 42–44) accompanying an order of the Board denying the petitioner's motion for reconsideration and modification of the decision is

not reported. The opinion of the Circuit Court of Appeals (R. 57–58) is reported in 65 F. (2d) 454.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 15, 1933. (R. 58.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The respondent acquired all the assets of another corporation and assumed its liabilities, including its outstanding bonds. Did the respondent realize taxable income by the purchase from the public in subsequent years of a number of the bonds at prices less than their par or face value?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set out in the Appendix, *infra,* pp. 10–11.

STATEMENT

The facts as stipulated and found by the Board of Tax Appeals (R. 21–25) may be summarized as follows:

In August 1914, the respondent acquired all of the assets of the Sen Sen Chiclet Company, a Maine corporation, and assumed the payment of its liabilities, among which were $2,425,000 par value of

bonds then outstanding and unredeemed. The bonds had been issued by the Sen Sen Chiclet Company in 1909 of a total face value of $2,700,000, maturing May 14, 1929, with a sinking-fund clause providing that a deposit be made with the trustee of at least $50,000 per year to provide for the purchase of bonds submitted to the trustee in open bid by bondholders under the terms of the indenture. (R. 21.)

During the year 1922, the respondent purchased from the public $82,000 par value of Sen Sen Chiclet Company bonds for which it paid a total of $55,650.94, making a difference of $26,349.06 between the par value and the redemption price.[1] (R. 21.) During the year 1924, the respondent and the trustee of the sinking fund purchased from the public $59,000 par value of these bonds, paying therefor $47,602.10, the difference between the par value of the bonds and the redemption price being $11,397.90. (R. 22–23.) During the year 1925, the respondent and the trustee of the sinking fund purchased a total of $201,500 par value of the bonds and paid therefor $186,146.31, or $15,353.69 less than the par value of the bonds. (R. 24.)

---

[1] The deficiencies in issue are for the taxable years 1924 and 1925. The amount of income for 1922 is involved in the computation of the amount of a statutory net loss for that year to be carried forward to the year 1924.

The Commissioner included the difference between the par value and the redemption price in income for each of these years. (R. 21–24.) The Board of Tax Appeals held that these amounts did not constitute taxable income. (R. 25–26.) On a rehearing, the Board reversed and modified its opinion upon another issue not now involved, but refused to alter its determination with respect to the present question. (R. 34–36.) Subsequently a motion for reconsideration and modification of the decision, filed by the Commissioner, was denied. (R. 40–44.) The Circuit Court of Appeals affirmed the decision of the Board. (R. 57–58).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the respondent realized no taxable gain or income by the purchase and retirement of the bonds at amounts less than their par value.

2. In affirming the order of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. We submit that the decision of the Circuit Court of Appeals is erroneous and in conflict with the principles underlying the decision of this Court in *United States* v. *Kirby Lumber Co.*, 284 U.S. 1. The Circuit Court of Appeals held here that where the taxpayer receives money for a bond obligation

and subsequently retires the bonds at less than par, taxable income is realized; but that where the obligation is incurred in the acquisition of property which it still holds, the obligor has not realized taxable gain by the purchase and retirement of the obligation. We believe that the decision in the *Kirby Lumber* case applies to both situations since it is based, not on the nature of the property acquired when the bonds are issued, but on the effect which their retirement has upon the financial situation of the obligor.

This Court held in the *Kirby Lumber* case that the taxpayer had realized an accession to income since "as a result of its dealings it made available $137,521.30 assets previously offset by the obligation of bonds now extinct." The same situation exists here. Presumably the value of the assets acquired by the respondent equaled the amount of the liabilities assumed; at least the respondent has not shown that the property was worth less. Therefore, at the time of this transaction, the assets were offset by equivalent obligations. By the use of its capital in its subsequent dealings the respondent has made available a portion of its assets free from the obligation of the bonds. In holding that this extinguishment of the obligation did not constitute taxable income the decision of the court below is also apparently in conflict with the basis of the decisions in *Chicago, R. I. & P. Ry. Co.* v. *Commis-*

sioner, 47 F. (2d) 990 (C.C.A. 7th), certiorari denied, 284 U.S. 618, and *Charleston & W. C. Ry. Co.* v. *Burnet,* 50 F. (2d) 342 (App.D.C.), which hold that unpaid wages, carried in a suspense account awaiting demands of employees, are to be treated as income in the year in which they are charged to profit and loss on the assumption that they will never be claimed.

The error of the court below lies, we believe, in its disregard of the fact that the situation here involves two independent transactions. In the first, property was acquired and its cost fixed by the amount of the obligations assumed in consideration therefor. The cost of the property was then determined as definitely as if the payment had been made in cash. Since the respondent's books were kept on the accrual basis (R. 25), there is no significant distinction between a payment made by decreasing assets on the one hand or by increasing liabilities, as in this case. So far as the purchase of the property was concerned it was a completed transaction when the respondent assumed the liability represented by the bonds. The bonds were thereafter retired in a separate series of transactions occurring in subsequent years between the respondent and persons other than the corporation from which the property was acquired. Whether gain or loss arises on the subsequent payment of

the obligation is a matter to be considered by itself, with its own tax results. There seems to be no basis for the holding that the cost of the property acquired by the assumption of the obligation of bonds remains uncertain, perhaps over a period of many years, until it appears whether the bonds will be paid in full or bought at a reduced figure. If the property was sold before the bonds were retired, no one would contend, we submit, that the cost of the property was incapable of determination because the outstanding bonds might thereafter be retired at less than their face value.

The Government should not be required to await the sale or disposition of the assets before taxing the gain realized by the favorable retirement of the bonds. The income-tax statutes are based upon a system which taxes gains annually rather than one which must await the final outcome of a given transaction. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359.

2. The decision below is in direct conflict with that of the Circuit Court of Appeals for the First Circuit in *Commissioner* v. *Coastwise Transp. Corp.*, 62 F. (2d) 332. There the taxpayer issued serial notes in part payment of the purchase price of a fleet of ships. It subsequently retired the notes at less than face value by purchases for cash and by the substitution of bonds. The Circuit Court of Appeals, relying on the *Kirby Lumber* case, re-

versed the Board and held that on the facts taxable income resulted.[2] We submit there can be no distinction between a case in which a corporation issues its own bonds in the purchase of property and a case in which the corporation acquiring the property assumes the obligation of the bonds. The court below in the instant case made no such distinction but rested its decision upon the difference between obligations whose consideration is money and those issued or assumed for property which the obligor still holds.

3. The question presented is involved under all of the Revenue Acts and is of importance from an administrative standpoint. The Bureau of Internal Revenue advises that there are pending at

[2] Since the decision in the *Coastwise Transportation* case was handed down, the Board has taken additional evidence under the mandate of the Circuit Court of Appeals and has reached the conclusion that the decision in the *Kirby Lumber* case does not apply, since the additional evidence indicated that by reason of operating losses and depreciation the taxpayer's balance sheets showed deficits at the beginning of each of the taxable years. See *Coastwise Transportation Corp.* v. *Commissioner*, decided by the Board of Tax Appeals July 21, 1933, and not yet reported. An extract from the opinion may be found in Vol. I, Prentice-Hall, 1933, p. 2234. An appeal has been authorized from the new decision of the Board, which is considered erroneous because of the failure to treat the retirement of the notes as separate transactions in the years in which they occurred. The new decision of the Board, we believe, shows the need for a further consideration by this Court in order to determine the extent of the application of the decision in the *Kirby Lumber* case.

present ten cases involving more than $650,000 in taxes in which the specific question is presented whether a successor corporation acquiring property from its predecessor by the assumption of the predecessor's obligations derives income upon a subsequent retirement of such obligations at less than their par value. Moreover, as we have indicated above, the decision below is equally applicable to a situation where the taxpayer has itself issued the obligation in the acquisition of property. It may be noted also that the regulation provides that where bonds are retired at a price in excess of the issuing price or face value the difference is a deductible expense for the taxable year. Cf. Article 545 (1) of Regulations 62, 65, and 69 (*infra*, p. 11). The proper treatment of all such situations is left in confusion because of the conflict between the decision in the instant case and that in the case of *Commissioner* v. *Coastwise Transp. Corp., supra.*

Wherefore it is respectfully submitted that this petition should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

AUGUST 1933.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 254:

> SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.
>
> SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

The provisions of Sections 233 (a) and 213 (a) of the Revenue Act of 1924, c. 234, 43 Stat. 253 (U.S.C., Title 26, Sections 985 and 954) and the Revenue Act of 1926, c. 27, 44 Stat. 9 (U.S.C.App., Title 26, Sections 985 and 954) are the same as the

above-quoted provisions of the Revenue Act of 1921.

Regulations 62, promulgated under the Revenue Act of 1921:

> ART. 545. *Sale and retirement of corporate bonds.*—(1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. See section 234 of the statute and article 563. (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

The provisions of Article 545 (1) of Regulations 65 and 69 promulgated under the Revenue Acts of 1924 and 1926 are the same as the above-quoted provisions of Article 545 (1) of Regulations 62.

U. S. GOVERNMENT PRINTING OFFICE: 1939

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes and regulations involved	2
Statement	4
Specification of errors to be urged	6
Summary of argument	6
Argument:	
I. Preliminary statement	8
II. The purchase at less than face of the bonds assumed by the respondent resulted in taxable income measured by the difference between the face value of the bonds and the cost of retirement	10
Conclusion	23

CITATIONS

Cases:	
American Tobacco Co. v. *Commissioner*, 20 B.T.A. 586	9
B. F. Avery & Son, Inc., v. *Commissioner*, 26 B.T.A. 1393	19
Bowers v. *Kerbaugh-Empire Co.*, 271 U.S. 170	8, 20, 21
Burnet v. *John F. Campbell Co.*, 50 F. (2d) 487	15
Burnet v. *Sanford & Brooks Co.*, 282 U.S. 359	16, 21
Burnet v. *S. & L. Building Corp.*, 288 U.S. 406	16
Charleston & W. C. Ry. Co. v. *Burnet*, 50 F. (2d) 342	13
Chicago, R. I. & P. Ry. Co. v. *Commissioner*, 47 F. (2d) 990, certiorari denied, 284 U.S. 618	13
Coastwise Transportation Corp. v. *Commissioner*, 22 B.T.A 373, reversed, 62 F. (2d) 332	9
Commissioner v. *Coastwise Transp. Corp.*, 62 F. (2d) 332	8, 18
Commissioner v. *Langwell Real Estate Corporation*, 47 F. (2d) 841	13
Commissioner v. *Rail Joint Co.*, 61 F. (2d) 751	20
Commissioner v. *Simmons Gin Co.*, 43 F. (2d) 327	15
Consolidated Gas Co. of Pittsburgh v. *Commissioner*, 24 B.T.A. 901	9, 18
F. G., Inc., v. *Commissioner*, 47 F. (2d) 541	17
Garland Coal and Mining Co. v. *Commissioner*, 28 B.T.A. 348	9
Great No. Ry. Co. v. *Lynch*, 292 Fed. 903	15
Houghton & Dutton Building Trust v. *Commissioner*, 20 B.T.A. 591	9
Independent Brewing Co. of Pittsburgh v. *Commissioner*, 4 B.T.A. 870	9
Kirby Lumber Co. v. *Commissioner*, 19 B.T.A. 1046	9
Lincoln Bank & Trust Co. v. *Commissioner*, 51 F. (2d) 78	17
Lucas v. *Schneider*, 47 F. (2d) 1006, certiorari denied, 284 U.S. 622	16
McLaughlin v. *Alliance Ins. Co.*, 286 U.S. 244	17
Maryland Casualty Co. v. *United States*, 251 U.S. 342	12

Cases—Continued. Page

Norfolk Southern Railroad Co. v. *Commissioner*, 22 B.T.A. 302, reversed 63 F. (2) 304 ..... 9, 18

Norfolk Southern Railroad Co. v. *Commissioner*, 25 B.T.A. 925 9

Old Colony Trust Co. v. *Commissioner*, 59 F. (2d) 168 17

Rail Joint Co. v. *Commissioner*, 22 B.T.A. 1277, affirmed, 61 F. (2d) 751 9

Rodrigues v. *Edwards*, 40 F. (2d) 408 17

Suncrest Lumber Co. v. *Commissioner*, 25 B.T.A. 375 ..... 9, 18

Terre Haute, Indianapolis & Eastern Tract. Co. v. *Commissioner*, 24 B. T.A.197 9

United States v. *Kirby Lumber Co.*, 284 U.S. 1 ..... 6, 8, 9, 10, 12, 18, 20, 22, 23

Woodward Iron Co. v. *Commissioner*, 24 B.T.A. 1050 ..... 9, 18

Woolford Realty Co. v. *Rose*, 286 U.S. 319 16

Statutes:

Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 254:

Sec. 213 2

Sec. 233 2

Revenue Act of 1924, c. 234, 43 Stat. 253:

Sec. 213 (U.S.C., Title 26, Sec. 954) 3

Sec. 233 (U.S.C., Title 26, Sec. 985) 3

Revenue Act of 1926, c. 27, 44 Stat. 9:

Sec. 213 (U.S.C. App., Title 26, Sec. 954) 3

Sec. 233 (U.S.C. App., Title 26, Sec. 985) 3

Miscellaneous:

Treasury Regulations 45:

Art. 33 17

Art. 51 14

Art. 544 ..... 8, 22

Treasury Regulations 62:

Art. 33 17

Art. 50 14

Art. 545 ..... 3, 22

Treasury Regulations 65:

Art. 33 17

Art. 49 14

Art. 545 ..... 4, 22

Treasury Regulations 69:

Art. 33 17

Art. 49 14

Art. 545 ..... 4, 22

Treasury Regulations 74:

Art. 53 17

Art. 64 14

Art. 68 ..... 8, 22

Treasury Regulations 77:

Art. 53 17

Art. 68 ..... 8, 22

In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 349

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

AMERICAN CHICLE COMPANY

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The original opinion of the Board of Tax Appeals (R. 10–16) is reported in 23 B.T.A. 221. A memorandum opinion (R. 22–23) accompanying an order of the Board denying the Commissioner's motion for reconsideration and modification of the decision is not reported. The opinion of the Circuit Court of Appeals (R. 28–30) is reported in 65 F. (2d) 454.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 15, 1933. (R. 30.) The petition for a writ of certiorari was filed August 15, 1933, and certiorari was granted October 9, 1933. (R. 30.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The respondent acquired all the assets of another corporation and assumed its liabilities including its outstanding bonds. Did the respondent realize taxable income by the purchase from the public in subsequent years of a number of the bonds at prices less than their par or face value?

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 254:

> SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, * * *.
>
> SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, busi-

nesses, commeree, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

The provisions of Sections 233 (a) and 213 (a) of the Revenue Act of 1924, c. 234, 43 Stat. 253 (U.S.C., Title 26, Sections 985 and 954), and the Revenue Act of 1926, c. 27, 44 Stat. 9 (U.S.C.App., Title 26, Sections 985 and 954), are the same as the provisions of the Revenue Act of 1921 set out above.

Regulations 62, promulgated under the Revenue Act of 1921:

ART. 545. *Sale and retirement of corporate bonds.*—(1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. See section 234 of the statute and article 563. (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

The provisions of Article 545 (1) of Regulations 65 and 69 promulgated under the Revenue Acts of 1924 and 1926 are the same as the above-quoted provisions of Article 545 (1) of Regulations 62.

STATEMENT

The facts material to the issue as they were stipulated and found by the Board of Tax Appeals (R. 11–13) may be summarized as follows:

In August, 1914, the respondent acquired all the assets of the Sen Sen Chiclet Company, a Maine corporation, and assumed the payment of its liabilities, among which were $2,425,000 par value of bonds then outstanding and unredeemed. The bonds had been issued by the Sen Sen Chiclet Company in 1909 of a total face value of $2,700,000, maturing May 14, 1929, with a sinking-fund clause providing that a deposit be made with the trustee of at least $50,000 per year to provide for the purchase of bonds submitted to the trustee in open bid by bondholders under the terms of the indenture. (R. 11.)

In 1922, the respondent purchased from the public $82,000 par value of Sen Sen Chiclet Company bonds for which it paid a total of $55,650.94, making a difference of $26,349.06 between the par value and the redemption price.[1] (R. 11.)

[1] The deficiencies in issue are for the taxable years 1924 and 1925. The amount of income for 1922 is involved in the computation of the amount of the statutory net loss for that year to be carried forward to the year 1924.

During the year 1924 the respondent purchased from the public $15,000 par value of these bonds and paid therefor $11,391, and the trustee of the sinking fund also purchased from the public $44,000 par value of the bonds, paying therefor $36,211.10, the difference between the par value of such bonds and the redemption price paid being the amount of $11,397.90. (R. 12.) During the year 1925 the respondent purchased $166,500 par value of the bonds from the public and paid therefor $152,016.81 and the trustee of the sinking fund likewise purchased from the public $35,000 par value of the bonds, and paid therefor $34,129.50, the difference between the par value of the bonds and the redemption prices paid therefor being $15,353.69. (R. 13.)

The Commissioner included the difference between the par value and the redemption price in the taxpayer's income for each of these years. (R. 11, 12, 13.) The Board of Tax Appeals held that these amounts did not constitute taxable income. (R. 13–14.)

Two other issues which are not now involved were presented for decision by the Board, namely, the proper treatment during the year 1924 of the amount by which the face value of certain of respondent's notes purchased for retirement during that year exceeded the purchase price and a question as to the right of the respondent to deduct as an expense the excess of the purchase price over the

issuing price plus the total deduction for the amortization of discount allowable to the date of purchase on other of its notes.

Upon rehearing granted at the instance of the Commissioner the present respondent conceded upon authority of *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, decided after the promulgation of the original opinion, that it realized gain upon the purchase of its own notes at less than the price at which they were issued. The Board declined to modify its prior decision with respect to the effect of the purchase of the Sen Sen Chiclet Company bonds. (R. 18–19.) Subsequently, a motion for reconsideration and modification of the decision filed by the Commissioner was denied. (R. 20–21.) The Circuit Court of Appeals affirmed the decision of the Board. (R. 28–30.)

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that the respondent realized no taxable gain or income by the purchase and retirement of the bonds at amounts less than their par value.

2. In affirming the order of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The petitioner contends that the principle underlying this Court's decision in *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, is applicable without regard to the nature of the property acquired and governs

the instant case. When the respondent assumed the liability of the Sen Sen Chiclet Company's bonds it acquired assets presumably equal in value to the liabilities assumed. When the respondent purchased some of the bonds at less than face in subsequent years it made available assets previously offset by the obligation of the bonds. To the extent that the taxpayer's surplus was increased because of the reduction of the liability of the bonds, taxable income was realized.

There is no proper basis for the theory of the court below that no taxable gain could be realized until there was a disposal of the property originally acquired. Income may arise from the reduction of a liability, thus increasing net worth, as well as from an increase in value of the property subsequently realized by a sale or other disposition. Since the income tax laws are based upon the results of annual transactions there is no need to await the sale of the property before taxing the gain realized upon the extinguishment of an obligation incurred in acquiring the property. Here there were separate and independent transactions. In the first, the assets were acquired and their cost was definitely fixed when the respondent assumed the obligation of the bonds. The bonds were retired in subsequent years in a separate series of transactions between the respondent and persons other than the corporation from which the property was acquired. Such separate transactions gave rise to

taxable income in the years when they occurred. Since income may be derived by the receipt of property as well as cash, the difference in facts between the instant case and the *Kirby Lumber* case should not lead to a different result. The decision in *Commissioner* v. *Coastwise Transp. Corp.*, 62 F. (2d) 332 (C.C.A. 1st), supports the petitioner's position.

We believe that the decision of this Court in *Bowers* v. *Kerbaugh-Empire Co.*, 271 U.S. 170, was based on the fact that the whole of the property acquired had been lost, and that the subsequent favorable retirement was merely a diminution of the loss—a situation which does not exist here. The reasoning of the court below, followed to its logical conclusion, demonstrates the unsoundness of the decision as a practical matter under a system taxing annual gains.

ARGUMENT

I

PRELIMINARY STATEMENT

The regulations have consistently provided that where a corporation retires its bonds at less than face it realizes income to the extent of the excess of the issuing price or face value over the purchase price.[2]

Prior to the decision of this Court in *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, the Board of Tax Appeals in a number of decisions held, con-

[2] Regulations 45, Article 544 (1) (c); Regulations 62, 65 and 69, Article 545 (3) (c); Regulations 74 and 77, Article 68 (1) (c).

trary to the regulations, that no taxable income is realized by a taxpayer upon the purchase of its bonds at less than their face value.[3] Subsequent to the *Kirby Lumber* decision in which this Court approved the Commissioner's regulations as a correct statement of the law, certain of the prior Board decisions holding that no taxable income was realized were reversed by the Circuit Courts of Appeals.[4] The Board of Tax Appeals has since followed the *Kirby Lumber* case in subsequent decisions.[5]

In the instant case the Board in its original opinion, promulgated before the decision in the *Kirby*

[3] See *e.g.*, *Independent Brewing Co. of Pittsburgh* v. *Commissioner*, 4 B.T.A. 870; *Houghton & Dutton Building Trust* v. *Commissioner*, 20 B.T.A. 591, and cases cited; *Rail Joint Co.* v. *Commissioner*, 22 B.T.A. 1277, affirmed 61 F. (2d) 751 (C.C.A. 2d:); *Terre Haute, Indianapolis & Eastern Traction Co.* v. *Commissioner*, 24 B.T.A. 197.

[4] *Kirby Lumber Co.* v. *Commissioner*, 19 B.T.A. 1046, reversed on stipulation of counsel, January 29, 1932 (C.C.A. 5th); *American Tobacco Co.* v. *Commissioner*, 20 B.T.A. 586, reversed on stipulation of counsel, January 21, 1932 (C.C.A. 2d); *Houghton & Dutton Building Trust* v. *Commissioner*, 20 B.T.A. 591, reversed per curiam December 21, 1931 (C.C.A. 1st); *Norfolk Southern Railroad Co.* v. *Commissioner*, 22 B.T.A. 302, reversed, 63 F. (2d) 304 (C.C.A. 4th); *Coastwise Transportation Corporation* v. *Commissioner*, 22 B.T.A. 373, reversed, 62 F. (2d) 332 (C.C.A. 1st).

[5] *Consolidated Gas Co.* v. *Commissioner*, 24 B.T.A. 901; *Woodward Iron Co.* v. *Commissioner*, 24 B.T.A. 1050; *Suncrest Lumber Co.* v. *Commissioner*, 25 B.T.A. 375; *Norfolk Southern Railroad Co.* v. *Commissioner*, 25 B.T.A. 925; *Garland Coal and Mining Co.* v. *Commissioner*, 28 B.T.A. 348.

Lumber case, held that the respondent realized no income by purchasing, at less than face, bonds of its predecessor and its own notes. Upon rehearing after the *Kirby Lumber* decision, the Board held, upon concession by the respondent, that taxable income was derived upon the repurchase of the notes, but declined to modify its decision with respect to the bonds on the ground that this liability had been assumed in connection with the purchase of capital assets and that the favorable retirement was merely a reduction in the purchase price of property which the respondent continued to own. Upon the same ground the Circuit Court of Appeals affirmed the Board's decision with respect to the retirement of the bonds.

We contend that the principle underlying the decision in the *Kirby Lumber* case applies irrespective of the nature of the property acquired and consequently that the decision below was erroneous.

II

THE PURCHASE AT LESS THAN FACE OF THE BONDS ASSUMED BY THE RESPONDENT RESULTED IN TAXABLE INCOME MEASURED BY THE DIFFERENCE BETWEEN THE FACE VALUE OF THE BONDS AND THE COST OF RETIREMENT

In *United States* v. *Kirby Lumber Co., supra,* the taxpayer had issued bonds for which it received their par value. Neither the opinion of this Court nor the findings of the Court of Claims (71 C.Cls. 290) disclose whether the payment for the bonds was in cash or other property. During the same

year the taxpayer repurchased some of the bonds at $137,521.30 less than par or face value. In holding that this amount constituted taxable income this Court said (284 U.S. 3):

> Here there was no shrinkage of assets and the taxpayer made a clear gain. As a result of its dealings it made available $137,521.30 assets previously offset by the obligation of bonds now extinct. We see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here. * * *

The principle so stated is equally applicable here. At the time the respondent assumed the Sen Sen Chiclet Company's obligation on the bonds it acquired property of the latter company presumably equal in value to the obligation of the bonds which it assumed; at least there is nothing in the case to show that the property was worth less. No taxable income was derived at the time, since the property acquired was offset by equivalent obligations. But when in subsequent years the respondent purchased some of the bonds, at less than face then as a result of its dealings, it reduced its liabilities, and to the extent of the difference, increased its surplus free from the liability of the bonds now extinct. The proposition is simply that a reduction in liabilities may result in income as much as

an increase in assets. That is the proposition, we submit, which was decided in the *Kirby Lumber* case. The decision there was based not on the nature of the property acquired when the bonds were issued, but on the effect which their retirement had upon the financial situation of the obligor.

In *Maryland Casualty Co.* v. *United States,* 251 U.S. 342, this Court recognized that taxable gain may result from the release of assets to the general uses of the owner. While this Court refused to hold that the diminution of the reserve constituted income since it did not clearly appear that any portion of the reserve was released to the free use of the taxpayer during the taxable year, this Court said (p. 352):

> If, in this case, it were due to an overestimate of reserves for 1912 with a resulting excessive deduction for that year from gross income and if such excess was released to the general uses of the company and increased its free assets in 1913, to that extent it should very properly be treated as income in the year in which it became so available, for the reason that in that year, for the first time, it became free income, under the system for determining net income provided by the statute, and the fact that it came into the possession of the company in an earlier year in which it could be used only in a special manner, which permitted it to become non-

taxable would not prevent its being considered as received in 1913 for the purposes of taxation, within the meaning of the act.

The "reserve" in insurance computation is merely a particular kind of liability. When the Court in the *Maryland Casualty* case spoke of the excess of reserve being "released to the general uses of the company," what it referred to was simply a reduction in the liability item for reserves in the company's balance sheet during the year in question. By this reduction in liabilities, the company's net worth was increased, and this Court held that this increase was taxable income.

The courts have held in other cases that taxable income is realized in the year when corporate funds are considered to be free from contingent obligations and released to the general uses of the corporation. Cf. *Charleston & W. C. Ry. Co.* v. *Burnet,* 50 F. (2d) 342 (App.D.C.); *Chicago, R. I. & P. Ry. Co.* v. *Commissioner,* 47 F. (2d) 990 (C.C.A. 7th), certiorari denied 284 U.S. 618; *Commissioner* v. *Langwell Real Estate Corporation,* 47 F. (2d) 841 (C.C.A. 7th). Here upon the purchase of the bonds the respondent's liabilities were reduced and its net worth was correspondingly increased over what it had been immediately before by the amount of the difference between the face value of the bonds and the retirement price. We contend that this constituted a real material gain to the respondent which was subject to tax in the year when the transaction occurred.

The decision below seems to be based upon the theory that since property rather than cash was acquired when the obligation was incurred, no taxable gain could be derived until the property originally acquired was disposed of. We submit there is no basis in reason for this theory. Income may arise from an increase in value of property on the one hand, which is taxable when realized by a sale or other disposition of the property. But taxable gain may likewise result, at least in the case of a solvent going concern, from the reduction of an obligation by the payment of a smaller amount, thereby increasing the excess of assets over liabilities. The gain here was not a growth or increment in value of the property acquired—such a gain would not be derived as income until the property itself is disposed of. The present gain resulted from the employment of the respondent's capital combined with its good fortune or skill in taking advantage of the opportunity of extinguishing a portion of its obligations before maturity by the expenditure of a lesser amount than the face of the obligations. It was a gain derived by the respondent from dealings in its obligations rather than its property.

In a somewhat similar situation, the regulations have consistently provided that the cancellation and forgiveness of indebtedness of a taxpayer gives rise to taxable income where such cancellation was not intended as a gift. Regulations 45, Article 51; Regulations 62, Article 50; Regulations 65 and 69,

Article 49; Regulations 74, Article 64. This we believe to be a correct construction of the law although in unusual cases, as where the debtor was insolvent, the courts have held that such cancellation does not result in taxable income. Cf. *Burnet* v. *John F. Campbell Co.*, 50 F. (2d) 487 (App.D.C.); *Commissioner* v. *Simmons Gin Co.*, 43 F. (2d) 327 (C.C.A. 10th). In the latter case the court indicated that the transaction might have resulted in a taxable gain had the corporation been solvent so that the release of the liability would have contributed to an excess of assets over liabilities. Where there has been no question of solvency it has been held that taxable income resulted. Cf. *Great No. Ry. Co.* v. *Lynch*, 292 Fed. 903 (Minn.); *B. F. Avery & Son, Inc.* v. *Commissioner*, 26 B.T.A. 1393.

There is no need for income tax purposes to consider as one indivisible transaction the acquisition of the property in return for the assumption of an obligation, the reduction of the obligation, and the subsequent sale of the property acquired, and thus compel taxation of the gain derived from the obligation to await the disposal of the property. In fact such considerations are opposed to the accepted method of determining taxable income. The income tax laws are based upon a system which considers the results of annual accounting periods rather than one which must await the final outcome of any given transaction. Only by such a system is

it practicable to produce a regular flow of income and apply methods of accounting, assessment and collection capable of practical operation. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359, 363–365; *Woolford Realty Co.* v. *Rose*, 286 U.S. 319, 326.

The principle that gain is determined upon the basis of annual accounting periods is plainly applicable here since there were in fact separate and independent transactions. In the first, property was acquired and its cost fixed by the amount of the obligations assumed in consideration therefor. The cost of the property was then determined as definitely as if the payment had been made in cash. Since the respondent's books were kept on the accrual basis (R. 13), there is no significant distinction between a payment made by decreasing assets on the one hand, or by increasing liabilities, as in this case. So far as the purchase of the property is concerned it was a completed transaction when the respondent assumed the liability represented by the bonds. The situation is indistinguishable from that in *Burnet* v. *S. & L. Building Corp.*, 288 U.S. 406, and *Lucas* v. *Schneider*, 47 F. (2d) 1006 (C.C.A. 6th), certiorari denied, 284 U.S. 622, where it was held that an existing mortgage assumed by a purchaser is to be included as part of the purchase price in finding the vendor's profit.

The cost of the property having thus been determined the question of gain or loss upon its disposition is a matter which has to do with future trans-

actions with that property and which bears no relation to future dealings in the bonds. The bonds were retired in subsequent years in a separate series of transactions between the respondent and persons other than the corporation from which the property was acquired. The question of gain or loss in subsequent dealings in the obligation incurred is a matter properly to be considered by itself with its own tax results, entirely apart from the ultimate disposition of the property originally acquired.

Since the gain here resulted from the respondent's dealings in its obligation there should be no need to consider the nature of the assets acquired when the obligation was incurred. But even if such consideration is given we believe it does not affect the fact that taxable income was derived. Income may be derived in the form of property as well as cash. *MacLaughlin* v. *Alliance Ins. Co.*, 286 U.S. 244, 249; *Lincoln Bank & Trust Co.* v. *Commissioner*, 51 F. (2d) 78 (C.C.A. 6th). It has been frequently held that where services are paid for in property the fair market value of the thing taken in payment is to be reported as income of the recipient. *Old Colony Trust Co.* v. *Commissioner*, 59 F. (2d) 168 (C.C.A. 1st); *F. G., Inc.*, v. *Commissioner*, 47 F. (2d) 541 (C.C.A. 7th); *Rodrigues* v. *Edwards*, 40 F. (2d) 408 (C.C.A. 2d). The regulations are to the same effect. Regulations 45, 62, 65, and 69, Article 33; Regulations 74 and 77, Article 53. If the respondent had received

assets of the Sen Sen Chiclet Company in payment for services taxable income would have resulted, measured by the fair market value of the property received, to the same extent as if payment had been made in money. The sole important factual distinction between the instant case and the *Kirby Lumber* case is that here the original increase in assets, offset by equivalent obligations, took the form of property instead of cash.[6] Since income may be derived in either form the distinction in facts can lead to no different result and the *Kirby Lumber* decision governs the case.

The sole decision which we have found directly in point, other than the decision of the court below, is that of the Circuit Court of Appeals for the First Circuit in *Commissioner* v. *Coastwise Transp. Corp.*, 62 F. (2d) 332. There the taxpayer issued serial notes in part payment of the purchase price of a fleet of ships. It subsequently retired the notes

---

[6] We do not believe there can be any distinction in principle due to the fact that the respondent assumed the obligation rather than issuing it in the first instance, and the court below felt that this difference would not require a different result. (R. 29.) Furthermore, although the *Kirby Lumber* case dealt with a situation in which the bonds had been issued and purchased within the same year, it has been subsequently recognized that a case may fall within the purview of that decision although the bonds are purchased during a later year. *Norfolk So. Railroad Co.* v. *Commissioner*, *supra*; *Consolidated Gas Co. of Pittsburgh* v. *Commissioner*, *supra*; *Woodward Iron Co.* v. *Commissioner*, 24 B.T.A. 1050; *Suncrest Lumber Co.* v. *Commissioner*, *supra*.

at less than face value by purchases for cash and by the substitution of bonds. The Board held that no taxable income arose from the retirement of the notes. The Circuit Court of Appeals reversed the Board on the authority of the *Kirby Lumber* decision. While the opinion does not discuss the fact that property instead of cash was originally acquired, this fact clearly appeared in the court's statement of the case and was evidently considered insufficient to affect the applicability of the *Kirby Lumber* decision. Upon the taxpayer's insistence that because of losses suffered and depreciation of its assets there was no release of assets, or in the alternative that the transaction was in effect a reorganization, the court remanded the case to the Board to determine these facts. The Board has since taken additional testimony and has adhered to its previous decision on two grounds, (1) that there was no release of free assets and (2) that the case is governed by the decision of the court below in the instant case. The Commissioner has filed a new petition for review of the decision of the Board rendered on rehearing.

In *B. F. Avery & Son, Inc.*, v. *Commissioner*, 26 B.T.A. 1393, the Board of Tax Appeals has taken a position which we believe is inconsistent with its decision in the instant case. There the taxpayer purchased certain manufacturing equipment and finished products and gave its notes in part payment. Subsequently some of the notes were can-

celled by the seller because of defects in the property sold. The Board held that income was derived from the cancellation of the taxpayer's obligations, relying on the *Kirby Lumber* decision and the fact that the income tax laws are based on fixed annual accounting periods. The court below recognized that its decision in *Commissioner* v. *Rail Joint Co.*, 61 F. (2d) 751, has no application here and we agree that such is the case. There the taxpayer had acquired no property by the issue of its bonds which it subsequently retired so that there had been no increase in its assets at any time.

We believe that the decision of this Court in *Bowers* v. *Kerbaugh-Empire Co.*, 271 U.S. 170, was based on the peculiar facts of the case and cannot be taken to mean that in the usual situation the Government must await the sale of the assets acquired before taxing the gain realized by the favorable retirement of the obligation. In the *Kerbaugh-Empire* case the taxpayer had borrowed money repayable in marks and the money so borrowed had been lost before any repayment was made. Thus before the taxpayer had satisfied the obligation the assets had been wiped out leaving only a liability. Under the circumstances this Court felt that the mere diminution of the amount of the loss did not constitute taxable income. Since the consideration received had been lost in its entirety the taxpayer had neither made a profit on the transaction nor received any money or property which could have

been made subject to the tax. Cf. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359, 364.

In the present case, the assets received were not wiped out in advance of retirement of the obligation and the case does not present a situation in which there was nothing more than the diminution of a loss. The assets remained subject to the respondent's use and a clear gain was realized as a result of transactions between the respondent and the public, separate and distinct from that in which the assets were acquired. This Court has not shown a disposition to extend the doctrine of the *Kerbaugh-Empire* case beyond the particular situation presented (cf. *Burnet* v. *Sanford & Brooks Co., supra*) and we submit that it should not govern here.

The reasoning upon which the case was decided below, when followed to its logical conclusion, will engraft unwarranted limitations upon the accepted system of determining gain or loss on the result of annual transactions. If the cost of the property remains undetermined until the obligation is retired no gain or loss can be computed upon the sale of the property as long as the obligation remains outstanding. So if a corporation acquires the assets and assumes the liabilities of another and sells the assets in the following year but does not retire the obligations until twenty years thereafter, no gain or loss may be computed on the sale of the assets until twenty years after it has taken place. The same result would follow where property was

purchased partly for cash and partly by the issue or assumption of bonded indebtedness. Under similar reasoning, if property acquired by the assumption of the indebtedness is destroyed by fire or other casualty no deduction may be taken in the year when the loss was sustained since the cost of the property is still uncertain as long as the obligation is unsatisfied. Moreover, if cost remains undetermined there would be no proper basis for depreciation and kindred allowances. Again, where bonds issued for property are retired at a premium, the regulations have consistently provided that the amount of the premium is a deductible expense when paid. Regulations 45, Article 544 (1) (b); Regulations 62, 65, and 69, Article 545 (3) (b); Regulations 74 and 77, Article 68 (1) (b). This deduction should not be allowed if the amount of the premium is merely added cost of the property acquired.

These implications of the decision below demonstrate its unsoundness as a practical matter under a system taxing annual gain or income. We submit that the limitations it places on such a system are not required by a statute which taxes generally all gains from whatever source derived, and are not permissible under the regulations (*supra*, p. 2) which this Court expressly approved "as a correct statement of the law" in *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, 3.

CONCLUSION

The case is ruled in principle by the decision of the *Kirby Lumber* case. The decision of the court below is erroneous and should be reversed.

Respectfully submitted.

J. CRAWFORD BIGGS,
Solicitor General.
ERWIN N. GRISWOLD,
SEWALL KEY,
NORMAN D. KELLER,
Special Assistants to the Attorney General.

DECEMBER, 1933.

U. S. GOVERNMENT PRINTING OFFICE: 1933

INDEX

	Page
Reply brief for the petitioner	1
Conclusion	8

CITATIONS

Cases:	
Burnet v. *S. & L. Building Corp.*, 288 U.S. 406	7
Commissioner v. *Coastwise Transp. Corp.*, 62 F. (2d) 332	6
Lucas v. *Schneider*, 47 F. (2d) 1006, certiorari denied, 284 U.S. 622	7
United States v. *Kirby Lumber Co.*, 284 U.S. 1	1
Miscellaneous:	
I.T. 2406, VII–1 Cumulative Bulletin 68	5

In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 349

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner.

v.

AMERICAN CHICLE COMPANY

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE PETITIONER

I

The respondent contends that this case is not controlled by this Court's decision in *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, and bases its distinction between the two cases on the ground that in the *Kirby Lumber* case the taxpayer was a "borrower of money" while in the present case the taxpayer was a "purchaser of property." The respondent asserts (Br. 4) that in the *Kirby Lumber* case the taxpayer's bonds were issued "for money," and this same assertion is apparently the sole ground of the decision of the court below. (R. 29.)

We have already pointed out in our main brief (p. 10) that there is no basis for the assumption that the taxpayer in the *Kirby Lumber* case was a borrower of money and received cash in return for the bonds which it issued. The findings of the Court of Claims in that case do not disclose what payment was made for the bonds. They simply state that $12,126,800 of the bonds in question "were issued at par on July 16, 1923," and that the Kirby Lumber Co. received "the par value of the bonds issued, without incurring expense incident to the issue of the said bonds." (R. 12 in No. 26, October Term, 1931; 71 C.Cls. 290, 291–292.)

Moreover, the contention now made by the respondents and adopted by the court below was presented to this Court in the *Kirby Lumber* case. In stating the facts of the case in its brief in opposition to the Government's petition for certiorari, the taxpayer there asserted (p. 2) that the bonds in question "were not issued for cash, as stated by petitioner." And on p. 9 of the brief in opposition the same point was presented in more detail. The taxpayer there said:

> Counsel fully realizes that the Government would not intentionally mislead this Court for the purpose of securing the writ which is sought. However, a most serious distortion of facts is presented * * * because the Kirby Lumber Company DID NOT RECEIVE CASH for the bonds here involved.

> The bond issue simply resulted in a change in the capital structure of the corporation. Prior to the bond issue the balance sheet showed preferred stock as a liability, while after the bond issue the bonds were shown as the liability. There was no gain or profit, and no cash was received.

In answer to this argument in the brief in opposition the Government filed a reply brief in which it was contended (p. 1) that the Government's conclusion as to the facts was "a fair interpretation of the special findings of fact of the Court of Claims," but that, in any event (pp. 2–3), "whether the respondent received cash for the bonds is immaterial, since in some form the price received was 'the par value of the bonds issued.' "

On April 20, 1931, this Court granted the writ of certiorari sought by the Government. On May 8, 1931, the taxpayer filed a motion to remand the case to the Court of Claims "with instructions to make a finding with reference to the consideration received by the Kirby Lumber Company for the bonds issued by it in 1923." In this motion to remand it was again asserted (p. 2) that "No cash was received for the bonds," and the respondent contended that its motion should be granted "if the court believes the consideration received for the bonds is material." The Government opposed the motion to remand on the ground, among others, that "it is immaterial whether the respondent received cash or securities for the bonds."

When the Government's brief on the merits was filed, the taxpayer's contentions with respect to the facts were expressly recognized. The Government's brief did not assert that the bonds were issued for cash. It recited the taxpayer's statement as to the consideration received for the bonds, and then stated (Br. 2):

> The Government maintains that this does not alter the legal effect of the transaction so far as the present question is concerned. In any case, the Lumber Company received valuable consideration equal to the par value of the bonds. Upon issuing them, its assets and liabilities were increased in equal amounts.

In its opinion, this Court apparently accepted the Government's contention that the consideration received for the bonds was immaterial. In reciting the facts of the case, this Court said (284 U.S. 1, 2):

> In July, 1923, the plaintiff, the Kirby Lumber Company, issued its own bonds for $12,126,800 for which it received their par value.

It is to be noted that the Court did not say that the bonds were issued for cash. If it had regarded its decision as applicable only to bonds issued for cash, it seems probable that it would have said so. Moreover, the Government was the petitioner in the *Kirby Lumber* case, and consequently the burden was on it to present findings showing all facts necessary to establish its case; and since the findings

actually made by the Court of Claims did not disclose the consideration received for the bonds, they were necessarily read in the way least favorable to the Government's contentions.

From this recital of the record and briefs in the *Kirby Lumber* case, it seems to us to follow that this Court had squarely presented to it the question whether the nature of the consideration received for the bonds in a case such as this is a material factor, and that the decision of the Court must necessarily be taken as a decision that the nature of the consideration received is not material in the application of that case. We submit, therefore, that the *Kirby Lumber* case is direct authority for the Government's position here, and that the respondent's attempted distinction wholly fails.

II

The respondent also asserts that the principle that the purchase and retirement of an obligation incurred in connection with the purchase of property represents a payment on the purchase price of the property and is not a transaction giving rise to taxable gain "has heretofore been recognized and accepted by the petitioner." (Br. 8.) In support of this statement the respondent refers to a ruling of the Bureau of Internal Revenue issued in 1928 (I.T. 2406, VII–1 Cumulative Bulletin 68), and to the formal acquiescence of the Bureau in two decisions of the Board of Tax Appeals. The respond-

ent recognizes that the ruling relied on was issued before this Court's decision in the *Kirby Lumber* case, but states (Br. 9) that it "does not find that it has since been revoked or modified in any way."

The ruling referred to was adopted by the Bureau in conformity with a number of decisions of the Board of Tax Appeals which reached the opposite conclusion from that ultimately adopted by this Court. The ruling, and the acquiescenses in the Board's decisions, have not represented the Bureau's practice since this Court's decision in *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, as is shown by the Bureau's position in the present case and in *Commissioner* v. *Coastwise Transp. Corporation*, 62 F. (2d) 332 (C.C.A. 1st). They were regarded as so plainly inconsistent with this Court's decision in the *Kirby Lumber* case that it was not necessary that they should be formally withdrawn. In order that there may be no question as to the Bureau's current practice, however, they have now been formally withdrawn and revoked. See Appendix A (*infra*, pp. 9–10).

III

The fallacy in the respondent's position becomes apparent, we submit, when the transaction by which it acquired the property of the Sen Sen Chiclet Company is viewed from the point of view of the seller. So far as the seller is concerned, it would seem to be obvious that the sale price of the

property was fixed when the property was sold, and could not thereafter be affected by subsequent transactions between the purchaser and other parties. It would seem to be equally obvious that the price received by the seller of the property and the cost to the purchaser, being two aspects of the same transaction, could not be different amounts.

This Court has already held that where property subject to a mortgage is sold and the purchaser assumes the mortgage, the amount of the mortgage must be included as a part of the purchase price in finding the seller's profit. *Burnet* v. *S. & L. Building Corp.*, 288 U.S. 406. To the same effect is *Lucas* v. *Schneider*, 47 F. (2d) 1006 (C.C.A. 6th), certiorari denied, 284 U.S. 622. The respondent makes no effort to distinguish these cases in its brief. Since it is settled that in such a case the amount of the mortgage is a part of the sale price of the property, it follows as a necessary consequence, we submit, that the amount of the mortgage is a part of the cost of the property to the purchaser. There would seem to be no escape from this conclusion where, as here, the purchaser's books are kept on the accrual basis. (R. 13.) The amount of the mortgage assumed became an accrued liability as soon as it was assumed. The discharge of that liability for less than its face amount could not alter the fact that the respondent had undertaken to pay a greater amount. The cost of the property was fixed when it was bought, and this

fact was reflected as an accrued liability on the respondent's books. That the discharge of that liability for less than its face amount increased the respondent's financial worth is obvious, and that it produced taxable income is, we submit, decided in *United States* v. *Kirby Lumber Co.*, 284 U.S. 1.

CONCLUSION

This case is controlled by the decision in the *Kirby Lumber* case. The decision of the court below is erroneous and should be reversed.

Respectfully submitted.

J. CRAWFORD BIGGS,
Solicitor General.

ERWIN N. GRISWOLD,
Special Assistant to the Attorney General.

FEBRUARY, 1934.

APPENDIX A

[SEAL] TREASURY DEPARTMENT,
BUREAU OF INTERNAL REVENUE,
Washington, January 31, 1934.

OFFICE OF THE GENERAL COUNSEL

Hon. J. CRAWFORD BIGGS,
Solicitor General, Department of Justice,
Washington, D.C.

In re: *United States* v. *American Chicle Company*, 65 Fed. (2d) 454.

MY DEAR MR. SOLICITOR GENERAL:

In connection with the above-entitled case, which is now pending before the Supreme Court of the United States, the taxpayer has cited in support of its position the acquiescenses of the Commissioner in the decisions of the Board of Tax Appeals in Des Moines Improvement Company, 7 B.T.A. 279, C.B. VII–1, 9, and American Seating Company, 14 B.T.A. 328, C.B. VIII–2, 2. I.T. 2406, C.B. VII–1, 68, which follows I.T. 2195, C.B. IV–2, 36, is also relied upon by the taxpayer. These acquiescences and rulings, all antedating the decision of the Supreme Court in United States v. Kirby Lumber Company, 284 U.S. 1, represented an effort by the Bureau to conform to the then current decisions of the Board and lower courts.

Since the decision of the Supreme Court of the United States in *United States* v. *Kirby Lumber Company*, supra, the principle enunciated in the

above-mentioned decisions of the Board of Tax Appeals and the Bureau has not been followed and has not represented the position of the Bureau. Formal revocation of the acquiescences and rulings was considered unnecessary in view of the Supreme Court's decision. However, to eliminate any misconception respecting the present position of the Bureau, acquiescences in the decisions of the Board of Tax Appeals in Des Moines Improvement Company and American Seating Company have been formally withdrawn, and I.T. 2195 and I.T. 2406 have been formally revoked.

Sincerely yours,

E. BARRETT PRETTYMAN,
General Counsel.

U. S. GOVERNMENT PRINTING OFFICE: 1934

FILE COPY

SEP 9 1933

CHARLES ELMORE CR

No. 349.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,

against

AMERICAN CHICLE COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

BREED, ABBOTT & MORGAN,
Attorneys for Respondent,
15 Broad Street,
New York, N. Y.

WILLIAM C. BREED,
PAUL L. PEYTON,
Of Counsel.

INDEX.

Subject Index.

	PAGE
Opinions Below	1
Jurisdiction	2
Question Presented	2
Statutes and Regulations Involved	2
Statement	3
Argument	4

Citations.

Cases:	
Charleston & W. C. Ry. Co. *v.* Burnet, 50 Fed. (2d) 342	7
Chicago, R. I. & P. Ry. Co. *v.* Commissioner, 47 Fed. (2d) 990	7
Coastwise Transportation Co[illegible]. *v.* Commissioner, 28 B. T. A., decided July 21, 1933	6
Commissioner *v.* Coastwise Transportation Corp., 62 Fed. (2d) 332	4, 6, 7
United States *v.* Kirby Lumber Co., 284 U. S. 1	4, 5
Statutes:	
Revenue Act of 1921, c. 136, 44 Stat. 227, Secs. 213, 233	3
Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 213 (U. S. C., Title 26, Sec. 954)	3
Sec. 233 (U. S. C., Title 26, Sec. 985)	3
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 213 (U. S. C. App., Title 26, Sec. 954)	2, 3
Sec. 233 (U. S. C. App., Title 26, Sec. 985)	2
Miscellaneous:	
Treasury Regulations 62, Article 545	3
Treasury Regulations 65, Article 545	3
Treasury Regulations 69, Article 545	3

No. 349.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,

against

AMERICAN CHICLE COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

Opinions Below.

The opinion of the United States Board of Tax Appeals (R. 19-29) is reported in 23 B. T. A. 221. The memorandum opinion of the Board (R. 42-44) accompanying its order denying respondent's motion for reconsideration and modification of the decision is not reported. The opinion of the Circuit Court of Appeals (R. 57-58) is reported in 65 Fed. (2d) 454.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered May 15, 1933 (R. 58-59) and the petition for a writ of certiorari was filed August 15, 1933. The jurisdiction of this court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

Did respondent, American Chicle Company, realize taxable income upon the purchase at less than their face value of bonds of Sen Sen Chiclet Company, which bonds it had theretofore assumed in connection with the purchase of the assets of the Sen Sen Chiclet Company?

Statutes and Regulations.

"Revenue Act of 1926, c. 27, 44 Stat. 9:

Sec. 233. (a) In the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in sections 213 and 217 * * * (U. S. C. App., Title 26, Sec. 985).

Sec. 213. For the purpose of this title, except as otherwise provided in section 233—

(a) The term 'gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal services * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or in-

terest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever * * * (U. S. C. App., Title 26, Sec. 954)."

The above provisions are a re-enactment of the like numbered sections of the Revenue Acts of 1921, c. 136, 42 Stat. 227, and 1924, c. 234, 43 Stat. 253 (U. S. C., Title 26, Sections 985 and 954).

"Treasury Regulations 69:

Art. 545. *Sale and retirement of corporate bonds.*—(1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. * * * (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year."

The above Regulations are the same as those contained in Article 545 of Treasury Regulations 62 and 65 issued under the Revenue Acts of 1921 and 1924.

Statement.

The facts were stipulated before the United States Board of Tax Appeals (R. 21-25) and the summarization thereof and the statement of the case contained in the petition for the writ (p. 2-4) are not controverted.

Argument.

Aside from the usual claim that the case is highly important, the reasons assigned by petitioner for the granting of a writ of certiorari are:

> (1) That the decision of the court below is in conflict with the decision of this court in *U. S.* v. *Kirby Lumber Co.*, 284 U. S. 1, and
>
> (2) That the decision of the court below is in direct conflict with that of the Circuit Court of Appeals for the First Circuit in *Commissioner* v. *Coastwise Transportation Corporation*, 62 Fed. (2d) 332.

No Conflict with Decision in Kirby Lumber Co. Case.

The situation presented here is entirely different from that considered by this court in *U. S.* v. *Kirby Lumber Co.*, *supra*. In the latter case the taxpayer issued its bonds for money and in the same year purchased some of them for less than the issuing price. The difference was held to be taxable income since it represented a "clear gain," realized within the taxable year. However, in the present case, the taxpayer was not a borrower of money but was a purchaser of property, the obligation on the bonds which were subsequently purchased for less than their face value having been incurred as part of the purchase transaction. Furthermore the property so acquired was still held by the taxpayer during the taxable years and therefore no taxable gain or loss thereon was realized.

The facts show that in 1914 the taxpayer acquired the assets and property of the Sen Sen Chiclet Company, taking them subject to the liabilities of that company among

which were $2,450,000 par value of bonds (R. 21). During the taxable years the respondent discharged its liability on bonds having a face value of $342,500 for $289,399.65 (R. 21-24), a difference of $53,100.65, which the Commissioner of Internal Revenue held to be a taxable gain.

The Board of Tax Appeals reversed the holding of the Commissioner and, in affirming the decision of the Board, the court below states most clearly and succinctly the distinction between the present case where the bonds were assumed in connection with the purchase of property and the *Kirby Lumber Co.* case where the taxpayer had issued its bonds for money. The following is quoted from the decision (R. 58):

> "We can see no difference between bonds retired in the same year and later; nor between those issued in payment for property, and an existing mortgage assumed by the buyer when the property is transferred. But the distinction does seem to us critical between obligations whose consideration is money, and those issued or assumed for property which the obligor still holds. Every increase in the value of property might indeed be treated as a 'gain,' though that would involve appraising taxpayers' property each year; but such is not the notion underlying our system of taxation. The gain must be 'realized,' either by a sale of the property for money, or by its exchange for something else. Section 935, title 26, U. S. Code (26 U. S. C. A., §935). When a taxpayer gets money by issuing an obligation which he later discharges for less than its face, the transaction is completed, because money need not be sold or exchanged to be 'realized.' So we read United States *v.* Kirby Lumber Co., *supra,* 284 U. S., 1, 52 S. Ct. 4, 76 L. Ed. 131. But if he buys property by an obliga-

tion in the form of a bond, note, or the like, and if it remains in kind after the debt is paid, there can be no 'gain.' The cost has indeed been definitively settled, but that is only one term of the equation; as long as the other remains at large, there is no 'realized' gain.

No Real Conflict exists at this time between decision of Court below and those of any other Circuit Court of Appeals.

As a further reason for the granting of the writ petitioner alleges that a conflict exists between the decision of the Court below and that of the Circuit Court of Appeals for the First Circuit in *Commissioner* v. *Coastwise Transportation Corporation, supra.* The taxpayer there acquired a fleet of ships and in part payment of the purchase price issued its serial notes, which it later retired at less than the face value. The Circuit Court of Appeals held the difference to be taxable income and reversed the decision of the Board of Tax Appeals, remanding the case for a new hearing on the facts. Upon the evidence presented at the rehearing the Board found that the transaction as a whole was a loss, that the reduction in the purchase price of the notes did not affect a release of free assets previously offset by the obligation of the notes, and in its new decision promulgated July 21, 1933, 28 B. T. A. ....., held that under either the view of the First Circuit or that of the Second Circuit, as expressed in the present case, the taxpayer realized no taxable income upon the purchase of the notes.

In the petition for the writ the petitioner states (footnote 2, p. 8) that "an appeal has been authorized from the new decision of the Board, which is considered erroneous because of the failure to treat the retirement of the notes

as separate transactions in the years in which they occurred." This is the same error as is assigned in the petition (p. 8) with respect to the decision of the court below in the present case and it does not appear from an examination of the decision of the Circuit Court of Appeals in the *Coastwise Transportation Corporation* case that this specific question was either presented to or passed upon by that court. If this were not the case, it would seem unnecessary for the petitioner to take an appeal from the new decision of the Board.

It is submitted, therefore, that unless and until the First Circuit Court of Appeals decides that the issuance or assumption of bonds or notes for property, and the later retirement of such bonds or notes, constitute two independent transactions as contended for by petitioner, there is no real conflict existing between the decisions of the First and the Second Circuit Courts of Appeals. Any apparent conflict now existing may be dispelled when and if the specific question is presented to the First Circuit in the new appeal in the *Coastwise Transportation Corporation* case. In any event there do not seem to be sufficient grounds at the present time for issuing a writ in this case by reason of any conflict existing between the decisions of the Circuit Courts of Appeals.

Chicago, R. I. & P. Ry. Co. v. *Commissioner,* 47 Fed. (2d) 990 (C. C. A. 7th) certiorari denied 284 U. S. 618, and *Charleston & W. C. Ry. Co.* v. *Burnet,* 50 Fed. (2d) 342 (App. D. C.) cited and relied upon by petitioner deal with the recovery of expense items previously deducted in determining taxable income of a prior year and have no bearing whatever upon the question presented by this case. The decision of the court below in no way conflicts with these decisions.

WHEREFORE, it is respectfully submitted that the petition for a writ of certiorari to review the decision of the Circuit Court of Appeals for the Second Circuit should be denied.

Dated, New York, September 8, 1933.

WILLIAM C. BREED,
PAUL L. PEYTON,
Counsel for Respondent.

FILE COPY

No. 349

Office Supreme Court
FILED
JAN 10 19
CHARLES ELMORE
CL

IN THE

Supreme Court of the United States

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

against

AMERICAN CHICLE COMPANY,

Respondent.

On a Writ of Certiorari to the United States Circuit Court of Appeals, for the Second Circuit.

BRIEF FOR RESPONDENT.

BREED, ABBOTT & MORGAN,
Attorneys for Respondent,
15 Broad Street,
New York, N. Y.

WILLIAM C. BREED,
PAUL L. PEYTON,
Of Counsel.

INDEX.

	PAGE
Opinions Below	1
Jurisdiction	1
Question Presented	2
Statutes and Regulations Involved	2
Statement	3
Summary of Argument	4
Argument:	
I. This case is not controlled by *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, and no taxable gain was realized by respondent upon the purchase of the Sen Sen Chiclet Company bonds	6
II. The decision of the Court below is entirely consistent with the accepted method of computing income upon the results of annual transactions and should be affirmed	14
Conclusion	16

Citations.

	PAGE
Cases:	
American Seating Co. v. *Commissioner*, 14 B. T. A. 328	9
B. F. Avery & Son, Inc. v. *Commissioner*, 26 B. T. A. 1393	11
Bowers v. *Kerbaugh-Empire Co.*, 271 U. S. 170	11
Burnet v. *John F. Campbell Co.*, 50 F. (2d) 487	11
Charleston & W. C. Ry. Co. v. *Burnet*, 50 F. (2d) 342	11
Chicago, R. I. & P. Ry. Co. v. *Commissioner*, 47 F. (2d) 990, certiorari denied, 284 U. S. 618	11
Coastwise Transportation Corp. v. *Commissioner*, 28 B. T. A. 725	13
Commissioner v. *Coastwise Transportation Corp.*, 62 F. (2d) 332	12
Commissioner v. *Langwell Real Estate Corporation*, 47 F. (2d) 841	11
Commissioner v. *Rail Joint Co.*, 61 F. (2d) 751	11
Commissioner v. *Simmons Gin Co.*, 43 F. (2d) 327	11
Des Moines Improvement Co. v. *Commissioner*, 7 B. T. A. 279	9
Great No. Ry. Co. v. *Lynch*, 292 Fed. 903	11
Maryland Casualty Co. v. *United States*, 251 U. S. 342	11
United States v. *Kirby Lumber Co.*, 284 U. S. 1,	4, 5, 6, 7, 9, 12, 13, 16
Statutes:	
Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 254:	
Sec. 213	3
Sec. 233	3

PAGE

Revenue Act of 1924, c. 234, 43 Stat. 253:
Sec. 213 (U. S. C., Title 26, Sec. 954) 3
Sec. 233 (U. S. C., Title 26, Sec. 985) 3

Revenue Act of 1926, c. 27, 44 Stat. 9:
Sec. 213 (U. S. C. App., Title 26, Sec. 954) 2
Sec. 233 (U. S. C. App., Title 26, Sec. 985) 2

Miscellaneous:

IT 2406 Cum. Bul. VII-1, p. 68 9

Treasury Regulations 62:
Art. 545 3

Treasury Regulations 65:
Art. 545 3

Treasury Regulations 69:
Art. 545 3

IN THE

Supreme Court of the United States

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,
against
AMERICAN CHICLE COMPANY,
Respondent.

On a Writ of Certiorari to the United States Circuit Court of Appeals, for the Second Circuit.

BRIEF FOR RESPONDENT.

Opinions Below.

The opinion of the United States Board of Tax Appeals (R. 10-16) is reported in 23 B. T. A. 221. The memorandum opinion of the Board (R. 22-23) accompanying its order denying petitioner's motion for reconsideration and modification of the decision is not reported. The opinion of the Circuit Court of Appeals (R. 28-30) is reported in 65 Fed. (2d) 454.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered May 15, 1933 (R. 30), and the petition for a

writ of certiorari which was filed August 15, 1933, was granted October 9, 1933. The jurisdiction of this court rests upon Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

Did respondent, American Chicle Company, realize taxable income upon the purchase at less than their face value of bonds of Sen Sen Chiclet Company, which bonds it had theretofore assumed in connection with the purchase of the assets of the Sen Sen Chiclet Company?

Statutes and Regulations.

Revenue Act of 1926, c. 27, 44 Stat. 9:

> "Sec. 233. (a) In the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in sections 213 and 217 * * * (U. S. C. App., Title 26, Sec. 985).
>
> Sec. 213. For the purpose of this title, except as otherwise provided in section 233—
>
> (a) The term 'gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal services * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and

income derived from any source whatever • • • (U. S. C. App., Title 26, Sec. 954)."

The above provisions are a re-enactment of the like numbered sections of the Revenue Acts of 1921, c. 136, 42 Stat. 227, and 1924, c. 234, 43 Stat. 253 (U. S. C., Title 26, Sections 985 and 954).

"Treasury Regulations 69:

> Art. 545. *Sale and retirement of corporate bonds.*—(1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (See section 234 and article 563). (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year."

The above Regulations are the same as those contained in Article 545 of Treasury Regulations 62 and 65 issued under the Revenue Acts of 1921 and 1924.

Statement.

The facts were stipulated before the United States Board of Tax Appeals (R. 11-13) and the summarization thereof and the statement of the case contained in petitioner's brief (pp. 4-6) is not controverted.

Summary of Argument.

The present case is not within the scope of Article 545 of the Regulations and is not controlled by the decision in *United States* v. *Kirby Lumber Co.*, 284 U. S. 1. The Regulations apply in terms only to the purchase and retirement by a corporation of *its own bonds* issued for money as part of a loan transaction. Such was the nature of the transaction in the *Kirby Lumber Co.* case which approved the Regulations.

In the present case the bonds purchased by respondent Chicle Company for less than their face amount were bonds of the Sen Sen Chiclet Company, the liability on which respondent had theretofore assumed in connection with the purchase of the assets and property of that company in 1914. Respondent therefore was not a borrower of money as was the taxpayer in Kirby Lumber Co., but was a purchaser of property subject to the bond liability. The court below correctly held that the purchase of the bonds did not result in taxable gain but was merely a factor to be considered in fixing the cost of the property to respondent, and that the determination of gain or loss must await the sale or other final disposition of the property itself.

The contention of petitioner that respondent realized a gain from dealing in its obligations and that the purchase of the Sen Sen bonds for less than their face value in itself resulted in taxable gain, is unsound and based upon a theory, not supported by the facts, that respondent made a "short sale" of the bonds when it acquired the assets and property of the Sen Sen Company. The situation presented by the facts of this case is simply

a purchase of property coupled with a payment on the purchase price during the taxable years pursuant to the obligation assumed by respondent. There has been no completed transaction, no realization of any loss or gain to respondent because respondent still owns the property on which it has settled a bond liability at less than the face amount, resulting in a lower cost of the entire property. No sale, exchange or parting with title has taken place, and there are no means of knowing whether respondent will realize a profit or a loss on the transaction until and unless it sells or disposes of the property in question.

In order to lay any basis for ascertaining a taxable gain or loss under petitioner's theory, it would seem there would have to be an appraisal of the property to determine whether the total cost was in excess or less than such appraised value. However, an attempt to determine a gain or loss on this theory where no sale or parting with title has taken place and nothing has been realized upon the transaction would be contrary to the "notion underlying our system of taxation."

The decision of the court below recognizes and gives effect to the accepted method of computing income upon the basis of annual transactions. However the method urged by petitioner would permit of the computation of taxable income upon a basis of including fictitious gains or losses not actually realized by a sale or other disposition of the property. The decision of the court below is correct and not in conflict with the *Kirby Lumber Co.* case.

ARGUMENT.

I.

This case is not controlled by *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, and no taxable gain was realized by respondent upon the purchase of the Sen Sen Chiclet Company bonds.

In 1914 the respondent, American Chicle Company, acquired the assets and property of the Sen Sen Chiclet Company by purchase, taking them subject to the liabilities of the company, among which were $2,425,000 par value of bonds (R. 11). The Chicle Company was therefore obliged to meet and pay or otherwise adjust all of these liabilities in some way satisfactory to the creditors. The record does not indicate how the general liabilities were paid, settled or adjusted, but the record does disclose that so far as the taxable years here involved are concerned the Chicle Company discharged its liability on bonds having a face value of $342,500 for $289,399.65 (R. 11-13). The petitioner contends that under Article 545 of the Regulations and *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, the difference between these two amounts—$53,100.65—is a taxable gain.

The respondent's contentions, which were sustained by the Board of Tax Appeals (R. 10-23) and the court below (R. 28-30), are that the purchase of the bonds was not a separate completed transaction resulting in either gain or loss but merely represented payments on the purchase price of the property acquired from the Sen Sen Company; that the determination of gain or loss on the transaction

must await the sale or other disposition of the property itself, and that neither Article 545 of the Regulations nor the *Kirby Lumber Co.* case is controlling.

At the outset it should be noted that the Regulations apply in terms only to the purchase and retirement by a corporation of *its own bonds* presumably issued for money as part of a loan transaction. Such was the nature of the transaction in *Kirby Lumber Co.*, where this court held the "clear gain" resulting from the favorable purchase and retirement of the bonds to be taxable. In that case the purchase and retirement of the bonds was the final step in a transaction involving the borrowing and repayment of money and all the factors necessary to compute the gain on the transaction were fixed and determined during the taxable year. In other words the Regulations and the *Kirby Lumber Co.* case cover a situation where a corporation is both selling and buying its own bonds in the same manner that it would deal in securities of another company, or in commodities.

In the present case, however, the taxpayer was not the borrower of money represented by the bonds, but was a *purchaser of property,* the liability on the bonds having been assumed as an incident to the purchase of the assets and property of the Sen Sen Company. The subsequent purchase and retirement of the bonds, as in the case of the settlement of other liabilities, was merely an element by which the actual cost of the property was determined and fixed and was in no sense a separate and independent transaction resulting in taxable gain. This essential difference between the transaction considered in the *Kirby Lumber Co.* case and the one presented here was clearly

recognized by the court below and formed the basis of its decision. The court said (R. 29-30):

> "We can see no difference between bonds retired in the same year and later; nor between those issued in payment for property, and an existing mortgage assumed by the buyer when the property is transferred. But the distinction does seem to us critical between obligations whose consideration is money, and those issued or assumed for property which the obligor still holds. Every increase in the value of property might indeed be treated as a 'gain', though that would involve appraising taxpayers' property each year; but such is not the notion underlying our system of taxation. The gain must be 'realized', either by a sale of the property for money, or by its exchange for something else. Section 935, title 26, U. S. Code (26 U. S. C. A. §935). When a taxpayer gets money by issuing an obligation which he later discharges for less than its face, the transaction is completed, because money need not be sold or exchanged to be 'realized'. So we read *United States* v. *Kirby Lumber Co., supra,* 284 U. S. 1, 52 S. Ct. 4, 76 L. Ed. 131. But if he buys property by an obligation in the form of a bond, note, or the like, and if it remains in kind after the debt is paid, there can be no 'gain'. The cost has indeed been definitively settled, but that is only one term of the equation; as long as the other remains at large, there is no 'realized' gain."

Moreover, the principle, that the purchase and retirement of an obligation incurred or assumed in connection with the purchase of property, represents a payment on the purchase price of the property and is not a transaction giving rise to taxable gain has heretofore been recognized and accepted by the petitioner.

In a ruling issued in 1928 it was held that the discharge of a purchase money mortgage for less than its face amount did not give rise to taxable gain but was "merely a revision of the purchase price of the property as originally agreed upon."[1] Although this ruling was issued prior to the decision of this court in *Kirby Lumber Co.*, respondent does not find that it has since been revoked or modified in any way.

Furthermore, the petitioner has acquiesced in decisions of the United States Board of Tax Appeals holding that no gain results from the discharge for less than their face amount of obligations given or assumed as part of the purchase price of capital assets. *Des Moines Improvement Co.* v. *Commissioner*, 7 B. T. A. 279, acquiescence published Cum. Bul. VII-1, page 9; *American Seating Co.* v. *Commissioner*, 14 B. T. A. 328, acquiescence published Cum. Bul. VIII-2, page 2.

---

[1] "An opinion has been requested as to the effect for income tax purposes of a transaction involving the satisfaction for less than its face value of a purchase money mortgage on property bought by the M Company during the year 1926.

It appears that as part of the consideration for the property in question a purchase money mortgage for 10x dollars was given by the M Company. During the year 1927 the estate of the prior owner, desiring to realize on the mortgage, accepted the offer of the company of 7x dollars in cash in satisfaction thereof.

It is held that under the facts shown the transaction mentioned constituted merely a revision of the purchase price of the property as originally agreed upon and resulted in no income to the M Company for 1927. Proper adjustment should be made on the books of account of the company for the purpose of showing the actual cost of the property. In the event of subsequent sale of the property so acquired, the basis to be used in determining gain or loss for income tax purposes will be the amount paid in satisfaction of the mortgage (7x dollars) plus the amount of the balance of the consideration paid for the property." *IT 2406* Cum. Bul VII-1, p. 68.

The petitioner concedes that the alleged gain upon which he here seeks to impose a tax "was not a growth or increment in value of the property acquired" and admits that "such a gain would not be derived as income until the property itself is disposed of." Furthermore, petitioner does not question the holding of the court below that any attempt to determine a gain by an appraisal of the property would be contrary to "the notion underlying our system of taxation" which requires that "the gain must be 'realized', either by a sale of the property for money or by its exchange for something else" (R. 29).

The only ground urged by petitioner to sustain the tax is that respondent realized a gain from "dealings in its obligations rather than its property" (Br. p. 14); that the purchase of the Sen Sen bonds for less than their face value, in itself, gave rise to a taxable gain. This argument proceeds upon the theory that the purchase of the Sen Sen property and the assumption of the outstanding obligations was in effect a "short sale" of the bonds for a consideration in property equal in value to the face amount of the bonds; that the selling price of the bonds as well as the cost of the property were thereby definitely fixed; and that the subsequent purchase of the bonds for less than their face value completed the short sale transaction and resulted in a taxable gain.

It is submitted that this contention of petitioner disregards entirely the true nature of the transaction. What actually occurred in the present case was a purchase of property in 1914 followed by a payment on the purchase price during the taxable years pursuant to the obligation assumed. The respondent was not in any sense dealing in its obligations and the transaction had none of the char-

acteristics of a "short sale". A similar theory was advanced to sustain the tax in *Bowers* v. *Kerbaugh Empire Co.*, 271 U. S. 170, 175, but was definitely rejected by this court.

None of the cases cited and relied upon by petitioner lend any support to the contention of petitioner that the purchase of the bonds was a separate transaction giving rise to a gain.

Maryland Casualty Co. v. *U. S.*, 251 U. S. 342; *Charleston & W. C. Railway Co.* v. *Burnet*, 50 Fed. (2d) 342 (App. D. C.); *B. F. Avery & Son, Inc.* v. *Commissioner*, 26 B. T. A. 1393; *Burnet* v. *John F. Campbell Co.*, 50 Fed. (2d) 487; and *Commissioner* v. *Simmons Gin Co.*, 43 Fed. (2d) 327, all deal with the reduction or cancellation of liabilities which, when incurred, were deducted in computing net taxable income for a prior year. Such was also apparently the case in *Great Northern Railway Co.* v. *Lynch*, 292 Fed. 903.

In the instant case there is no question of restoring to taxable income an amount previously allowed as a deduction and the above cases do not touch the question here involved. Cf. *Commissioner* v. *Rail Joint Co.*, 61 Fed. (2d) 751.

Commissioner v. *Langwell Real Estate Corporation*, 47 Fed. (2d) 841, and *Chicago, R. I. & P. Railway Co.* v. *Commissioner*, 47 Fed. (2d) 990, have no relevancy since they involved situations entirely different from that presented by the facts of the instant case. Furthermore, in *Maryland Casualty Co.* v. *United States, supra*, this court did not hold as stated by petitioner (Br. p. 13) that the increase in net worth resulting from a decrease in reserves was taxable income. To the contrary the court states (p. 353):

> "* * * such deductions can be restored to income again only where it is clearly shown that the subsequent business conditions have released the amount of them to the free beneficial use of the company in a real and not in a mere bookkeeping sense * * *.
>
> "Since the findings of fact before us do not make the clear showing, which must be required, that the statutory deduction of net reserves in prior years was restored to the free use of the claimant in 1913 *it should not have been charged as income with the decrease in that year* * * *." (Italics ours.)

In *Commissioner* v. *Coastwise Transportation Corporation,* 62 Fed. (2d) 332 (C. C. A. 1) the taxpayer purchased for less than their face amount certain of its own obligations theretofore issued in part payment of a fleet of ships. Although the court expressed a belief that the case was controlled by *Kirby Lumber Co.,* it did not hold that the purchase of the obligations was a separate transaction as here contended by petitioner, but remanded the case to the Board of Tax Appeals for further hearing to determine if there had been a release of free assets as a result of the favorable purchase of the obligations. Since the transaction was essentially a purchase of property as in the present case, we believe that the court erred in holding that *Kirby Lumber Co.* was at all applicable. Furthermore, any gain computed under the holding of the First Circuit in the *Coastwise Transportation* case must necessarily be based upon an appraisal of property still owned by the taxpayer and would not represent a gain actually realized through a sale or other final disposition of such property.

On the rehearing the Board followed the decision of the Second Circuit Court of Appeals in the present case and held that the purchase of the obligations represented a

payment on the purchase price of the assets. It was further found that because of depreciation and losses sustained there had been no release of free assets and that even under the view taken by the First Circuit Court of Appeals there was no gain. *Coastwise Transportation Corp.* v. *Commissioner,* 28 B. T. A. 725. Petitioner states (Br. p. 19) that a petition for a review of the decision of the Board rendered on rehearing has been filed and in the petition for the writ of certiorari (footnote p. 8) it is stated that the new decision of the Board "is considered erroneous because of the failure to treat the retirement of the notes as separate transactions in the years in which they occur." Since the petitioner apparently agrees with the finding of the court below that taxable gains may not be determined upon the basis of appraisals but must await a sale or other final disposition of the property, it is clear that in both the present case and in the *Coastwise Transportation Corporation* case the petitioner is relying entirely upon the "short sale" theory under which it is asserted that the mere purchase of the obligations for less than their face amount gives rise to taxable gain.

The fundamental fact in this case is that the respondent was buying property and the purchase and retirement of the bonds attaching to such property was nothing more than a payment on the purchase price thereof. The contention of petitioner that respondent was dealing in its obligations and realized a profit upon the retirement of the bonds disregards entirely the real facts of the transaction and cannot be supported under any theory. Respondent submits that the court below correctly held that the present transaction was not controlled by the *Kirby Lumber Co.* case and that no gain will be realized until the property itself is sold or otherwise disposed of.

II.

The decision of the Court below is entirely consistent with the accepted method of computing income upon the results of annual transactions and should be affirmed.

Respondent submits that not only is it sound as a matter of law to consider the amount paid to retire the obligation as a factor in the determination of the cost of the property but that any proper accounting or business view of the present state of facts would not regard the transaction otherwise. The record does not indicate at what price the bonds were selling in the market at the time of the purchase of the assets of the Sen Sen Company but it is fair to assume that if they were selling at a discount this fact was taken into consideration at the time of the purchase and was a factor in determining the purchase price. It is also reasonable to conclude that when a business is purchased subject to the payment of its liabilities, the purchaser has in mind the possibility of paying off the liabilities for less than their face amount and considers that the actual cost of the property will be the amount paid at the time of the purchase plus the amount subsequently required to settle or dispose of the liabilities.

The petitioner argues (Br., p. 21) that if a corporation acquires property by assuming obligations and sells the property the following year but does not retire the obligations until twenty years thereafter, no gain or loss could be computed upon the sale of the property under the decision of the court below, until the obligations had been retired. Respondent submits that there is nothing in the

reasoning of the court below which puts any limitation upon the accepted method of computing gains upon the basis of annual transactions or which would require or permit computations of gains or losses to be made in the manner as stated by petitioner.

Where real property is acquired by the assumption of an obligation such obligation is ordinarily a lien upon the property itself and any subsequent sale of the property before the obligation is retired will in turn be made subject to such obligation. In such a case it is apparent that there would be no difficulty in computing gain or loss upon a sale of the property whether or not the obligation ha been retired prior thereto. If the obligation assumed was not a lien upon the property itself and was not retired prior to a sale of the property, the face amount of the obligation would be used in fixing the cost of the property for the purpose of computing gain or loss upon the sale. In that event the "cost basis" of the obligation would be fixed and if thereafter the obligation was discharged for less than its face amount taxable gain would be realizable.

It is submitted, however, that a computation of gains or losses in the manner contended for by petitioner would result in the taxing of gains not actually realized and result in distortions of income not consistent with the accepted method of computing income upon the basis of annual transactions. This is clearly shown by the following illustration:

Assume that A purchased an apartment building in 1926 for $100,000 paying $25,000 in cash and assuming a mortgage for $75,000. Thereafter, in 1932, A retired the mortgage obligation by the payment of $50,000 and in 1933 sold the property for $60,000. Disregarding any adjustment for depreciation, it is clear that A sustained an actual loss in

1933 of $15,000 upon the sale of the building. However, under the petitioner's theory A would be held to have realized a gain of $25,000 in 1932 upon the retirement of the mortgage and to have sustained a loss of $40,000 in 1933 upon the sale of the property. Under the decision of the court below the retirement of the mortgage in 1932 would properly be considered as an adjustment of the purchase price and the actual loss of $15,000 would be shown as having been sustained in 1933 when it was realized by the sale of the property.

The holding of the court below that no gain can be realized until the property itself is sold is entirely consistent with the accepted method of computing gains upon the basis of annual transactions and gives effect to the true nature of the transaction which was simply a purchase of property and the payment on the purchase price thereof in a subsequent year pursuant to the obligations assumed by petitioner.

Conclusion.

It is respectfully submitted that the decision of the court below is correct, is not in conflict with the decision of this court in *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, and should be affirmed.

BREED, ABBOTT & MORGAN,
Attorneys for Respondent,
15 Broad Street,
New York, N. Y.

WILLIAM C. BREED,
PAUL L. PEYTON,
Of Counsel.

SUPREME COURT OF THE UNITED STATES.

No. 349.—October Term, 1933.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner. *vs.* American Chicle Comany.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[March 5, 1934.]

Mr. Justice McReynolds delivered the opinion of the Court.

Assessments by petitioner which treated as realized income the difference between the face value of certain bonds assumed by respondent in 1914 and the amount at which it purchased them in 1922, 1924 and 1925, were disapproved by the Board of Tax Appeals. The court below affirmed this action, and the matter is here by certiorari. The meager stipulated facts present only a narrow point; and to that our decision must be limited.

Respondent is a New Jersey corporation the nature of whose business is undisclosed. Its books are kept on the accrual basis.

The Sen Sen Chiclet Company, incorporated under the laws of Maine, also carried on an undisclosed business. In 1909 it issued a series of 20 year bonds—whether secured by a lien, or otherwise, does not appear. The indenture under which they issued required that $50,000 be supplied each year which the trustee should use for purchasing outstanding bonds.

In 1914 respondent bought all assets of the Sen Sen Company. In part payment it assumed all outstanding liabilities of the seller—among them $2,425,000 of the 1909 bonds. There is nothing in the record to show the nature of these assets, or what became of them, or the outcome of the transaction.

Respondent purchased in 1922 $82,000 of the Sen Sen bonds for $55,650.94—$26,349.06 less than their face. During 1924 it and the trustee under the indenture purchased $59,000 of the same bonds for $47,602.10—$11,397.90 below their par value. Likewise, during 1925 they purchased $201,500 for $186,146.31—$15,353.69 less than their face.

The Commissioner treated these differences—$26,349.06, $11,-

397.90 and $15,353.69—as income realized by respondent. The Board of Tax Appeals ruled otherwise and said—

"The payments involved in the transactions under consideration were payments on the purchase price of the Sen Sen Chiclet Company's assets, paid, under the conditions of the agreement, to the holders of that company's bonds. When all of the bonds have been retired by the petitioner its obligations to the Sen Sen Chiclet Company will have been satisfied in full, and whatever the total amount paid to retire the bonds, it will constitute a part of the cost to petitioner of the Sen Sen Chiclet Co. assets."

In support of the same view, the Circuit Court of Appeals said—

"When a taxpayer gets money by issuing an obligation which he later discharges for less than its face, the transaction is completed, because money need not be sold or exchanged to be 'realized'. So we read *United States* v. *Kirby Lumber Co., supra,* 284 U. S. 1, 52 S. Ct. 4, 76 L. Ed. 131. But if he buys property by an obligation in the form of a bond, note, or the like, and if it remains in kind after the debt is paid, there can be no 'gain'. The cost has indeed been definitively settled, but that is only one term of the equation; as long as the other remains at large, there is no 'realized' gain."

We know nothing concerning the nature of the assets acquired from the Sen Sen Company, have no means of ascertaining what has become of them, or whether any of them still exist. Nothing indicates whether respondent lost or gained by the transaction.

The case before us is this:

In connection with the purchase of the assets of another company, in 1914, respondent assumed—promised to pay—more than $2,000,000 of the seller's outstanding bonds. During 1922, 1924 and 1925 it purchased a considerable number of these bonds in the market at less than their face. The Commissioner assessed the difference between these two amounts as income.

We find nothing to distinguish this cause in principle from *United States* v. *Kirby Lumber Co.,* 284 U. S. 1. The doctrine there announced is controlling here. *Bowers* v. *Kerbaugh-Empire Co.,* 271 U. S. 170 is not applicable. The final outcome of the dealings was revealed—the taxpayer suffered a loss. Here, for aught we know, there was substantial profit—certainly, the record does not show the contrary. Doubtless, respondent's books indicated a decrease of liabilities with corresponding increase of net assets.

Reversed.